

BEFORE THE INSURANCE COMMISSIONER
OF THE STATE OF WASHINGTON

In the Matter of the)
Application regarding the)
Conversion and Acquisition)
of Control of Premera Blue) Docket No. G02-45
Cross and its Affiliates)
)
)
)

Adjudicative Hearing
May 3, 2004
Day 1
Tumwater, Washington

Taken Before:

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P R O C E E D I N G S

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3 COMMISSIONER KREIDLER: Well, good morning everybody.

4 Now, I'm Washington State Insurance Commissioner Mike
5 Kreidler and we are all here for the - to consider the
6 application for conversion of Premera from a nonprofit
7 Premera Blue Cross - that is from a nonprofit to a
8 for-profit.

9 This is a process that has been underway for
10 approximately two years since the initial notification and
11 approximately 18 months since the formal application was
12 submitted to my office.

13 The application is being considered under the
14 requirements of the state Holding Company Act. It has been
15 my intent since this process began to make sure that it was
16 a very public process. We have made it very clear that we
17 are going to do that and that any information that was
18 submitted would be made available to the public.

19 We also held two rounds of public meetings in six
20 different cities, a total of eight different meetings. And
21 we have also established a Premera conversion page on the
22 Office of the Insurance Commissioner's website.

23 Of the 40,000 pages that have been submitted to date,
24 nearly all of those are currently available on the website.
25 During the public meetings some 120 individuals testified

1 and did so under oath and - and their opinions are now part
2 of the official record and have been posted. We have also
3 received literally thousands of postcards and numerous
4 individuals have contacted us either in writing or through
5 our website.

6 Last week we ran newspaper advertisements announcing
7 this hearing in 13 daily newspapers across the State of
8 Washington, announcing the hearing itself and also offering
9 to the public an opportunity for them to comment on this
10 application. That comment period for the public will
11 continue through May 21st.

12 The commitment to a public process during this hearing,
13 while taking place during this hearing, is one that will be
14 somewhat different for the general public. While they are
15 certainly invited to come and listen to the hearing, they
16 also will - will have the opportunity to submit their
17 comments either through the website of my Insurance
18 Commissioner's office or they can do so by mail. And as I
19 said, they are certainly welcome to attend.

20 There are three sets of players that are before us. The
21 initial portion here is going to be led by Premera. Then we
22 have the Office of the Insurance Commissioner. And we also
23 have third-party intervenors who have an interest and may be
24 affected by the decision on this question of conversion.

25 As an aside, I should point out that I have been walled

1 off from the OIC staff. Except for procedural matters and
2 issues of process, I have not been --

3 MR. SCHOENGARTH: Put that a little closer.

4 COMMISSIONER KREIDLER: A little closer? Okay.

5 I have not been in contact with the OIC staff. In fact,
6 their analyses and recommendations that will be presented as
7 a portion of this hearing will be the first time that I have
8 heard this testimony itself and their recommendations.

9 Procedurally, Judge Finkle will give you the details of
10 the process. Each of the parties will be able to present
11 their case. And today we are going to have a chance to here
12 from Premera, but initially there will be opening comments
13 from all three of the parties that are involved. By a
14 prearranged agreement, there is a proportionate amount of
15 time set aside for each of the parties.

16 After listening to the testimony and considering the
17 official record and comments that are made, I will weigh the
18 evidence and make a decision as to whether to approve or
19 deny the application. My ruling will be based on factors
20 identified in the Holding Company Act, which establishes my
21 authority to - to address this matter.

22 I'm not going to read you the law, but I can cite for
23 you several of the factors that I will be considering. And
24 they include Premera's financial stability, whether the
25 transaction is fair and reasonable, will subscribers be

1 treated fairly and reasonably, is the conversion in the
2 interest of the insurance buying public, will conversion
3 lessen competition.

4 Pursuant to - to the schedule that I established earlier
5 this year, this hearing will be concluded on May 18th and my
6 decision will be handed down by no later than July 19th.

7 It is now my pleasure to introduce my special master who
8 has worked on a number of - of the procedural aspects of -
9 leading up to the formal hearing. It is in the person of
10 former retired superior court judge, George Finkle. And you
11 will now hear from Judge Finkle as to the procedural matters
12 for this hearing.

13 Judge Finkle?

14 JUDGE FINKLE: Thank you, Commissioner Kreidler.

15 Good morning. The first order of business on the
16 schedule is the opening statements, but I want to invite any
17 preliminary issues before we move to the opening statements.

18 MR. KELLY: Judge Finkle, Tom Kelly. Just one, I
19 think, minor one. As you know, you had indicated that we
20 would have 30 minutes for opening Q & A for the witnesses
21 who have already filed extensive prefile. We have several
22 witnesses - and I suspect the other parties may as well -
23 who despite our best efforts to carve things down have a lot
24 of things to say. We would appreciate it if for a couple of
25 them we could go to perhaps 40 minutes or so.

1 Obviously that time is held against us in terms of our
2 clock. And we would gladly do the same thing if it arises
3 with any of the other Intervenors or the OIC staff.

4 JUDGE FINKLE: Comments from OIC staff?

5 MR. HAMJE: Your Honor, we have no objection.

6 JUDGE FINKLE: Intervenors?

7 MS. HAMBURGER: Your Honor, we have no objection.

8 JUDGE FINKLE: That would be fine. Let's keep it at
9 45 minutes at most.

10 MR. KELLY: Very good.

11 JUDGE FINKLE: Any other preliminary matters?

12 I believe we are ready to hear Premera's opening
13 statement.

14
15 OPENING STATEMENT

16 BY MR. MILO

17
18 MR. MILO: Good morning, Commissioner Kreidler,
19 Judge Finkle, Deputy Commissioner Sureau and Assistant
20 Attorney General Beusch. My name is Yori Milo. I'm the
21 chief legal and public officer for Premera and Premera Blue
22 Cross.

23 And I would like to introduce counsel representing
24 Premera in these proceedings. Tom Kelly and Rob Mitchell
25 seated on my right and Ramona Emerson and Fred Townsend of

1 the Preston Gates and Ellis law firm.

2 I would also like to introduce Gubby Barlow, Premera's
3 chief executive officer and director Sally Jewel, the chair
4 of the governance committee of Premera's board of directors
5 who are seated behind me at the first table. And Ms. Jewel
6 and Mr. Barlow will be Premera's first witnesses later
7 today.

8 We are hear today to present Premera's Form A filing at
9 hearing pursuant to the Holding Company Act. The Form A
10 seeks approval by the Commissioner of Premera's proposal to
11 reorganize the Premera company from their current status to
12 for-profit status so that the company can raise capital in
13 equity markets. That is, so that the companies can sell
14 shares in the stock markets for three purposes.

15 As the testimony shows, the three principle reasons for
16 seeking capital is, first, strengthen Premera's reserves;
17 second, support membership growth; third, provide a source
18 of funds for improvements to infrastructure like technology
19 and funding to develop new products and services to better
20 serve Premera's members.

21 I want to review for a minute some of the events leading
22 to today's hearing and some of the testimony that is being
23 submitted in this proceeding.

24 Commissioner, as you noted, it was May 2002 that Premera
25 first advised you and the Attorney General of its intent to

1 convert. Two years at the end of this month. Over that two
2 years, the OIC staff, at the direction of the Commissioner,
3 conducted an extensive examination and review of Premera's
4 proposal. The OIC staff retained an array of consultants
5 who examined tens of thousands of pages of materials,
6 conducted interviews of Premera's personnel, performed their
7 own analysis and prepared extensive formal reports as well
8 as testimony.

9 In addition, Premera also retained experts, experts to
10 study Premera's Form A filing and the reports of the state
11 consultants. And they too performed their own analysis of
12 the conversion proposal. Premera's experts have filed
13 expert reports and prefiled testimony, which is now in
14 evidence. And that also is important for your
15 consideration.

16 I want now to discuss briefly Premera's amended Form A
17 filing of February 2004 and the events that led to that
18 filing. The initial reports of the state consultants issued
19 in October of 2003 raised a range of concerns about
20 Premera's initial Form A filing. Premera and the OIC staff
21 together asked for a chance to discuss those concerns among
22 them and to work to narrow the issues of - in dispute.

23 Pursuant to your order, Commissioner, Premera and the
24 OIC staff did meet. They met extensively in December 2003
25 through January 2004. And the Intervenor's counsel,

1 consistent with your direction, were given an opportunity to
2 attend as observers.

3 The discussions between OIC staff, Premera and the OIC
4 consultants were, in fact, extremely helpful in finding
5 solutions to many of the issues and concerns raised in the
6 initial reports.

7 The product of those discussions is the Amended Form A,
8 which is the subject of this hearing. And Premera made
9 extensive changes in that Amended Form A to address the
10 concerns of the state consultants.

11 Premera will demonstrate at this hearing, and the
12 evidence shows, that Premera's conversion proposal as
13 contained in the Amended Form A not only meets the standards
14 for approval under the Holding Company Act, not only
15 provides significant benefits to Premera's subscribers, but
16 also provides a unique opportunity for the - for the
17 citizens of Washington and Alaska.

18 I want to turn now to the legal standards that apply to
19 Premera's conversion and how the evidence will show the
20 Amended Form A complies with those standards for approval.
21 The Holding Company Act standards are discussed in detail in
22 Premera's brief.

23 And I won't propose to review them all here, but it is
24 worth noting from the outset that on certain standards under
25 the Act, there is simply no dispute. The Form A meets those

1 requirements. First, as to Premera's ability to satisfy the
2 registration requirement as a health carrier, OIC staff, OIC
3 consultants and Premera agree that the reorganization does
4 not raise issues under that standard. Premera - Premera
5 meets subject registration requirements. And with respect
6 to financial wherewithal, the conversion would not
7 jeopardize Premera's financial condition, but rather
8 strengthen it.

9 Second, as to antitrust considerations, will the
10 reorganization have an anticompetitive effect? Again, there
11 appears to be no dispute between OIC consultants and staff
12 and Premera. This proposal does not pose anticompetitive
13 issues.

14 The evidence will also show that the conversion will
15 have no detrimental effect on Premera's subscribers, the
16 public interest or the insurance buying public. It will
17 have the opposite effect - the opposite positive effect.

18 As I said earlier, the testimony shows three principles
19 also for conversion and I would like to discuss that
20 testimony in a little more detail. First, conversion
21 strengthens Premera's capital reserves, reserves to assure
22 the fin- - financial stability of Premera so that it can
23 meet its obligations to its members, it can protect against
24 economic uncertainties and will have the capital flexibility
25 that it needs to benefit all its members who rely on those

1 reserves.

2 Second, conversion supports membership growth. That, of
3 course, brings Premera products to a broader range of
4 insurance buying public. At the same time, it has another
5 very important purpose. It spreads the costs of delivering
6 coverage over a broader base. That in turn helps mitigate
7 the upward pressure on premiums.

8 Third, conversion helps fund investments in
9 infrastructure, products and services. As the evidence
10 shows, it allows Premera to continue to respond to consumer
11 the demands for innovative products and services. As
12 testified by Mr. Barlow, it allows Premera to provide better
13 service for its members and providers. It allows Premera to
14 achieve efficiencies in administration, which again helps
15 hold down costs.

16 And as Drs. Gollhofer and Chauhan will testify, it helps
17 develop innovative care facilitation programs, programs that
18 benefit the health of Premera's members.

19 In sum, the capital from a conversion will benefit
20 subscribers in the public interest as well as the insurance
21 buying public directly as a result of Premera's ability to
22 improve its operations.

23 The next point I want to discuss is the creation of
24 charitable foundations as a result of the conversion,
25 another powerful, positive effect from the conversion.

1 Premera has proposed in connection with the conversion the
2 creation of charitable foundations to help address unmet
3 health needs for the residents of Washington and Alaska. As
4 Ms. Dingfield will testify, a foundation of this kind would
5 be of enormous benefits to Washingtonians.

6 So how does Premera's conversion create and fund these
7 foundations? The Premera Form A provides 100 percent of the
8 initial stock of New Premera would be given to two new
9 charities, one for Washington and one for Alaska subject to
10 the restrictions in the Form A filing. The value of that
11 stock which will be given to the foundations is estimated by
12 the state consultants in their reports to be in the 500
13 million to 100 million dollar range. Let's pause and
14 consider the testimony of unmet health needs in our
15 community and what a fund of this proportion could achieve.

16 The "Let's Get Washington Covered" task force, sponsored
17 by the Commissioner, dedicates substantial attention to the
18 unmet health needs in this state. The conversion provides a
19 tremendous opportunity to create an endowment, hundreds of
20 millions of dollars to address such unmet health needs in
21 Washington and Alaska.

22 Now, some have suggested that the size of the
23 foundations will be insignificant in comparison to the scope
24 of the health needs in our states. The Commissioner heard
25 that in public in testimony at the forums he conducted late

1 last year. The evidence is to the contrary. As Mr. Reid
2 testifies, the foundations proposed by Premera on a per
3 capita basis will be the largest health foundation created
4 anywhere in the United States as a result of a Blue
5 conversion.

6 By way of comparison, the Washington Health Foundation
7 respected for the work it does in the healthcare field, its
8 endowment is approximately 23 million dollars. The funds to
9 be created by the foundations resulting from this conversion
10 would be more than 20 times that amount.

11 So how have healthcare leaders in the community
12 perceived the potential impact of the foundations? As
13 Ms. Dingfield testified, health leaders across the state
14 have worked together to explore how funds resulting from a
15 Premera conversion could be used to the benefit of
16 Washingtonians. Those leaders have spoken out. They have
17 spoken out vigorously about the positive and profound impact
18 the foundations of the size we propose could have in these
19 communities.

20 One further point I would like to make relating to the
21 foundations, these foundations will be charitable
22 organizations. However, as the record reflects, Premera has
23 stated from the outset it is not a charity and that
24 testimony shows Premera is not a charity.

25 The Cantilo and Bennett report makes an assumption. It

1 assumes that Premera is some kind of charity or is some form
2 of public benefit corporation obliged to transfer its value
3 to the foundations. However, Mr. Cantilo has testified that
4 the report made that as an assumption. He further testified
5 he made that as an assumption without any legal inquiry.

6 And why did he make that assumption? He further
7 testifies that this assumption was made simply on
8 instructions to do so by OIC staff.

9 The Intervenors also make assertions that Premera is a
10 charity, but again those assertions are unsupported. Saying
11 so does not make it so and such unsupported assumptions and
12 assertions are not a valid basis for consideration in these
13 proceedings.

14 The prefiled testimony of Premera's witnesses by
15 contrast, and opinions of Premera's experts, filed as
16 evidence in this case show those assumptions and assertions
17 are not correct. And in any case, mere assumptions and
18 assertions about charitable obligations or an obligation to
19 transfer fair market value cannot serve as a basis for a
20 decision on Premera's Form A and they can't serve as a basis
21 to impose conditions on the approval of the Form A.

22 As the testimony reflects, Premera has proposed to
23 transfer 100 percent of the initial stock of New Premera to
24 the foundations, an enormous endowment, but subject to the
25 governance provisions of the Form A filing. Premera remains

1 committed to that proposal and the good works that these
2 foundations can do in these communities, but it does not
3 accept the unsupported proposition that it is obliged to
4 transfer more or that it is obliged to make such transfer
5 without the governance provisions of the Form A filing.

6 The next area I want to move to is the Amended Form A
7 itself and, as reflected in the testimony, the extensive
8 changes made to address the many concerns initially raised
9 by the state consultants. First, as to the consultants'
10 issues relating to subscriber premiums and provider
11 networks, the Amended Form A contains written assurances,
12 Commissioner, by Premera contained in Exhibit E-8 relating
13 to both premium rate settings and provider network.

14 How did those assurances come about? Mr. Marquardt
15 testified that those assurances were the product of a
16 collaborative effort with the state consultants to address
17 their concerns. The assurances were designed with the input
18 of the state consultants and the state consultants were
19 satisfied with those provisions and those assurances as
20 written with one exception.

21 Premera proposed that the assurances remain in place for
22 two years. The state consultants suggested a longer period.
23 And consistent with what they told Premera at the discussion
24 time, their view is reflected in their supplemental reports.

25 For reasons explained by Dr. McCarthy and Mr. Lusk in

1 their testimony, a longer period would put Premera at a
2 competitive disadvantage to the detriment of the
3 subscribers. But regardless, the only point of difference
4 between Premera and the state consultants about the
5 assurances was the time they would stay in effect.

6 So what do these economic assurances represent? They
7 represent the total of the relief the state consultants felt
8 was needed to speak to issues of subscriber premiums and
9 access to providers. While Premera does not agree that the
10 two-year term should be extended for the reasons stated by
11 its witnesses, the assurances do reflect how close Premera
12 and the state consultants have come on these important
13 issues.

14 Next I will comment on the compensation assurances
15 contained in the Amended Form A, Exhibits E-8 and G-10 to
16 the filing. Director Fahey and Mr. Furniss testified on
17 those assurances and the extensive changes Premera made in
18 the Amended Form A regarding stock programs.

19 Premera's stock program proposal includes adoption
20 wholesale of most of the restrictions proposed by the state
21 consultants. Let me review them in more detail. Premera's
22 proposed stock program prohibits any stock grants to any
23 executives, to any directors for a full 12 months after the
24 conversion. The stock program also imposes limits on the
25 total amount of stock that can be granted during the first

1 full three years after the conversion and includes not just
2 aggregate limits, but limits as to specific officer
3 positions.

4 How does this stock program compare to stock plans of
5 other companies? Mr. Furniss testifies that the Premera
6 stock plan is not only conservative, he testifies that it is
7 more restrictive than programs at other companies and
8 programs established in other Blue conversions.

9 Next, I want to comment on the extensive changes made to
10 the governance documents relating to the foundations and
11 their relationship to New Premera. Those documents in the
12 Amended Form A govern the organization of the foundation,
13 the provisions related to the sale of Premera's stocks and
14 the voting provision that is related to foundation shares.

15 Mr. Marquardt testified on the extensive revisions
16 Premera made to address the state consultants' concerns
17 about such provisions. For example, on the important issue
18 of independence of the foundations, extensive changes were
19 made to give assurance that the foundations operate in an
20 independent fashion. No Premera representatives will sit on
21 the foundation boards. And, in fact, Premera has proposed
22 that the Attorneys General of Washington and Alaska have the
23 power to appoint the foundation boards.

24 Also, extensive revisions were made to give the
25 foundation voting rights on certain key Premera decisions,

1 such as change in control proposals. The supplemental
2 reports issued by the state consultants in February 2004
3 reflect and confirm that major progress was made to address
4 the concerns raised in the initial reports.

5 Now, there are still concerns raised in the state
6 consultants' supplemental reports. Some of those, in fact,
7 have been resolved as reflected in the prefiled testimony
8 and the responsive testimony, including that of Mr. Cantilo.
9 And we appreciated his confirmation that some of these
10 issues have been adequately addressed, but some have not.

11 Commissioner, Premera did not include certain provisions
12 requested by the state consultants in the Amended Form A.
13 We acknowledge that. And the consultants have criticized
14 the Form A roundly for that.

15 I want - I would like to summarize the testimony on two
16 points. Why did Premera not include those provisions and
17 why does Premera believe these transaction elements are not
18 a valid basis to criticize the Form A?

19 I'm referring in particular to the state consultants'
20 request to provide both a Washington and Alaska foundation
21 each the following rights: First, a five percent voting
22 block of shares outside of the proposed voting trust;
23 second, separate as opposed to aggregate divestiture
24 schedules; and, finally, a right for each foundation to
25 nominate its own designee to the Premera board of directors

1 or, in the alternative, to allow Washington a designated
2 member and the Alaskan foundation an observer.

3 Without getting into the details of these provisions, I
4 want to explain why these provisions were not included.
5 Mr. Marquardt testified that Premera informed the state
6 consultants when they first raised these requests that it
7 could not include such provisions if those provisions would
8 cause a breach of its Blue Cross/Blue Shield license.

9 And Mr. Barlow testifies Premera made extensive efforts
10 to get approval of such provisions from the Blue Cross/Blue
11 Shield Association. Mr. Barlow requested a special meeting
12 of the Blue Association Committed - excuse me - the Blue
13 Association Committee charged with review of conversion
14 transactions to consider Premera's petition to permit such
15 terms.

16 Mr. Barlow, accompanied by Premera's in-house counsel,
17 appeared before the Blue Committee to advocate for such
18 terms. And we did so vigorously. And we had some success
19 in that effort. The Blue Association Committee has advised
20 it will recommend in favor of Premera's requests to allow
21 each of the foundations to designate a separate board
22 nominee to the board of directors. However, on the other
23 two issues I discussed, the committee refused to recommend
24 the waiver to the Blue license to permit the terms as we
25 requested.

1 A copy of Premera's petition to the Blue Association and
2 the Association's formal response are included as exhibits
3 to Mr. Barlow's prefiled testimony. They demonstrate the
4 lengths Premera went to try to satisfy the state's
5 consultants on these requests.

6 Mr. Barlow's testimony also addresses the role of the
7 Blue Cross/Blue Shield license as well as that of the Blue
8 Cross/Blue Shield Association, which I will refer to here as
9 the Blue Association. The Blue Association does not presume
10 to encroach on the Commissioner's authority nor does it seek
11 to dictate conversion terms.

12 The Association will, however, as is its right as the
13 owner of the Blue Cross/Blue Shield mark, strip Premera of
14 its Blue license if a conversion goes forward on terms
15 inconsistent with a Blue license.

16 Now, that Blue license is a significant asset for
17 Premera and for its members, as the state consultants
18 readily acknowledge and agree. Premera - Premera, as a
19 licensee, must comply with its license requirements in order
20 to continue to use the names and marks and very importantly
21 to access the Blue national network of providers, which is
22 so important to Premera's subscribers. Premera simply
23 cannot proceed with a conversion that jeopardizes the Blue
24 license and the value it brings to its members.

25 I want now to turn to concerns raised by the

1 Intervenors. Premera shares their general concern about
2 affordable premiums for subscribers, access to broad
3 provider networks and quality services. Indeed, as
4 Premera's directors testified, the board approved the
5 conversion - conversion proposal precisely to access the
6 capital Premera seeks to continue delivering value for its
7 members.

8 With due respect to the Intervenors, while recognizing
9 that Premera works collaboratively with many of them on a
10 broad range of issues other than the conversion, and we
11 respect their point of view, the testimony in this case
12 shows that their criticisms of the conversion are
13 unsupported by credible evidence.

14 Now, what do the Intervenors say? The Intervenors
15 assert by virtue of being a publicly traded company,
16 shareholder pressures per se will hurt consumers. Again,
17 they claim merely being a public company with shareholders,
18 meaning that the company will act against the interest of
19 its customers to the benefit of shareholders.

20 They assert that as a result, subscriber premiums will
21 increase and that access to providers and the levels of
22 benefits and services will diminish. They don't offer
23 evidence to support those assertions.

24 First, as to subscriber premiums, the evidence in this
25 case will show that conversion will not adversely impact

1 member premiums. To the contrary, the innovations and
2 efficiencies that can be funded by increased access to
3 capital will support efficient administration of services
4 and an ability to spread costs over a larger membership base
5 and also to continue development of important care
6 facilitation programs that contribute to the health of
7 Premera's members while helping keep costs in check.

8 The testimony also refers to studies in other
9 conversions. These were looked at by Premera and Intervenor
10 experts alike. Those studies did not find correlation
11 between prior conversions and increased premiums.

12 Second, as to concerns about provider reimbursement
13 levels, Dr. McCarthy testifies this is a competitive market
14 for provider services. He also testifies that conversion
15 will not impact provider reimbursements. That is supported
16 by studies in other conversions, studies commissioned by
17 other regulators. They demonstrate no correlation between
18 conversions and levels of provider reimbursement.

19 But the concern about provider reimbursement in and of
20 itself misses the point. What is the interest in this
21 proceeding? It is the interest of policyholders, not
22 bolstering provider compensation levels. As Mr. Ansel
23 (phonetic) testifies, there is an inherent tension between
24 provider demands for increased compensation and the
25 insurer's role in holding down costs.

1 Approximately 84 cents of every dollar Premera collects
2 in premiums is paid out to cover medical costs. Medical
3 cost increases result in subscriber premium increases. And
4 a very large driver, obviously, of medical costs is provider
5 reimbursements.

6 Finally, service levels: Again, the Intervenor's make
7 assertions that service levels will go down simply because
8 of shareholder pressures. The Intervenor's submit no
9 evidence for that proposition. Recent research published in
10 the New England Journal of Medicine demonstrates that the
11 Intervenor's assertions are at odds with the evidence.

12 But, again, the objections of the Intervenor's misses a
13 key and fundamental economic reality. Premera's business is
14 capital intensive. The innovations needed to help benefit
15 subscribers require capital. That is precisely what the
16 conversion is designed to do. And Premera has distinguished
17 itself as a Washington company known as an innovator in its
18 field to the benefit of its members.

19 Premera's infrastructure investments in recent years and
20 the Dimensions products and services, which resulted from
21 those investments, have been resounding successes in the
22 marketplace, that is with Premera's policyholders.

23 As Mr. Smith, Premera's CIO testifies, Premera is also
24 an innovator in technology solutions. Premera's technology
25 solutions have been appraised by the most sophisticated of

1 technology customers and the Government Accounting Office as
2 well.

3 Premera's care facilitation programs, in particular its
4 disease - oncology disease management program has received
5 national recognition. And Premera has been an active leader
6 in the Washington Healthcare Forum. Premera has
7 distinguished itself in its efforts to achieve
8 administrative simplification in collaboration with the
9 provider community.

10 In closing, we submit that the conversion will do the
11 following: It will give Premera the resources it needs to
12 continue its investment in the welfare of its current and
13 future members. It will support a Washington business that
14 is emerging as an innovative leader providing great service
15 to its customers. And, in addition, the conversion will
16 create an endowment of major proportions to support the
17 health of the residents of Washington and Alaska through the
18 proposed conversion.

19 Premera submits, Commissioner, that after considering
20 the evidence you should conclude that this application not
21 only meets the standards of the Holding Company Act, the
22 conversion also presents a great opportunity, a unique
23 opportunity, for the State of Washington. That opportunity
24 should be seized. The Premera Form A as filed should be
25 approved. Thank you, Commissioner.

1 JUDGE FINKLE: Thank you. OIC opening?

3 OPENING STATEMENT

4 BY MR. HAMJE

5
6 MR. HAMJE: Thank you, Your Honor, Commissioner. My
7 name is John Hamje. I'm a Special Assistant Attorney
8 General appearing on behalf of the OIC staff. Seated to the
9 my right is my co-counsel, Melanie deLeon, an Assistant
10 Attorney General. To my left is Jim Odiorne, who is the
11 Deputy Insurance Commissioner for company supervision at the
12 OIC who has acted in connection with the review of Premera's
13 application and is the coordinator of the OIC staff review
14 team.

15 Usually an opening statement is devoted to presenting a
16 preview of what a party intends to prove or what evidence
17 will be presented or the like. Here, as it always seems to
18 be the case, it is a truly unprecedented proposal. From the
19 Staff's perspective, it is not quite so simple.

20 The Staff has withheld formulating its recommendation
21 and presenting it to the Commissioner until after all of the
22 evidence has been received. This is unheard of in a
23 run-of-the-mill Form A proceeding where the proposal would
24 probably not even get to hearing without the applicant first
25 securing the Staff's favorable recommendation. But then

1 again, this is hardly a run-of-the-mill Form A.

2 In the usual case, information is exchanged between the
3 Staff and the applicant informally through discussions and
4 correspondence. Here, although candid and open discussions
5 have been held that yielded much progress, there has been a
6 greater reliance on formal discovery, such as depositions,
7 for exchanging information about the consultants' views of
8 the application and Premera's responses to those views.

9 Depositions are certainly a useful tool in litigation,
10 but they are not the most efficient way of exchanging
11 information about a Form A. It is a little bit like using a
12 microscope to look up something in the Encyclopedia
13 Britannica. Therefore, the Staff has delayed formulation of
14 its recommendation until the evidentiary record is complete
15 and the forest, as well as the trees, is visible.

16 After Premera has made its case and their experts have
17 testified and we have heard the views of the Staff's
18 consultants and from the Intervenor, the Staff will be in a
19 position to make and present its recommendation.

20 My focus, then, in the few minutes I have will be on
21 what the Staff expects in this proceeding. But it is
22 important first to make clear the Staff's position
23 concerning the criteria to be applied by the Commissioner.

24 I want to assure you that neither the Staff nor the
25 Attorney General is even a little bit confused about what

1 criteria are to be applied in evaluating Premera's
2 application. The criteria has been established by the
3 legislature and may be found in Chapters 48.31B and 48.31C
4 of the insurance code.

5 Provisions in both chapters apply because two domestic
6 insurers, as well as two domestic healthcares (sic), are
7 affected by Premera's proposal and because they are parties
8 to the proposed transaction or subject to a change in
9 control or both.

10 I'm not going to go over the criteria with you again at
11 this time. I believe we are all pretty familiar with it.
12 But they are listed on Pages 3, 4 and 5 of the Staff's
13 prehearing memorandum regarding the issues.

14 Instead, I would like to talk to you about the issues.
15 From the Staff's point of views, the issues for the
16 Commissioner's determination may by subsumed under one or
17 more of four general questions.

18 First, will the fair market value of Premera's assets be
19 transferred upon its dissolution to the foundation
20 shareholders taking into consideration the proposed
21 restrictions on the ownership and sale of the stock of the
22 new for-profit holding company?

23 This involves an analysis of the structure of the
24 proposal as well as the impact of stock restrictions and the
25 stock divestiture schedule on the value of the assets

1 proposed to be transferred to the foundation shareholders.

2 In this connection, I think it is useful to point out
3 that although it appears all of the parties are present and
4 accounted for, one is absent. Its presence is nonetheless
5 evident in Premera's application. And much of the time of
6 its proceeding will be devoted to discussing the footprints
7 left by its rules and regulations. And, of course, I'm
8 talking about the Blue Cross/Blue Shield Association.

9 In its application Premera justifies the imposition of
10 restrictions on the use and limitations on the sale of stock
11 as due to compliance with the requirements of the
12 Association, otherwise it claims its membership in the
13 Association may be forfeit and the Blue mark is at risk.

14 The next question is will subscribers, particularly
15 those in Eastern Washington, be disadvantaged as a result of
16 the implementation of the proposal either through increases
17 in premiums in excess of the healthcare trend or through
18 reduction of accessibility to providers. This involves the
19 PricewaterhouseCoopers Economic Impact Analysis and
20 Premera's response to it, the Economic Impact Assurances.

21 Third, will the executive management of Premera
22 improperly benefit from the conversion through compensation
23 practices that are not adequately performance-based or
24 sufficiently aligned with the interests of Premera's future
25 shareholders and other key stakeholders?

1 There is no question that Premera's current management
2 stands to benefit on a personal level from the approval of
3 the application and a subsequent public offering. Public
4 companies simply pay more to their executives than do
5 nonprofit companies. The real issue is whether the benefit
6 constitutes unjust enrichment.

7 Fourth, how will Premera satisfy the Commissioner that
8 there has been no material change in the circumstances
9 relied upon in review of the proposal between the date the
10 proposal is approved, if approved, and the date of its
11 implementation?

12 The Staff will also present evidence concerning the
13 so-called allocation issue, the one issue about which the
14 Staff has taken a position, that a fair allocation will
15 result in 85 percent to 88 percent of Premera's assets to be
16 received for the benefit of Washington citizens. This does
17 not directly affect Premera's interest, but is a necessary
18 consequence of Premera's application if approved.

19 Since Premera, or more technically correct, Premera Blue
20 Cross, a subsidiary, operates in both Washington and Alaska,
21 its assets, when distributed, must be fairly apportioned
22 between the citizens of the two states through the use of
23 the two foundation shareholders. One in Washington, the
24 other in Alaska.

25 Although the Staff and the Alaska Division of Insurance

1 staff have worked diligently to develop a joint proposal
2 that could be submitted to you and the Alaska director for
3 approval, our efforts have not been rewarded with success.
4 Therefore, the Staff will submit to you all of the
5 information that has been developed by the Staff's
6 consultants and we expect that all of the available related
7 information developed by Alaska's consultants will be
8 submitted to you as well so that you, if inclined to approve
9 the proposal, may determine Washington's citizens fair share
10 of Premera's assets.

11 A charitable trust issue will also be the subject of
12 much of this hearing. In our prehearing memorandum the
13 Staff did not touch upon this issue, but we believe it will
14 be useful to share with you the Staff's perspective on it at
15 this time. Whether the assets of the nonprofit seeking to
16 convert in other states were the subject of charitable
17 limitations was a question that loomed large in many of
18 those proceedings.

19 Premera's proposal is designed to reflect the lessons
20 learned from those proceedings. In the Staff's view, the
21 proposal effectively sidesteps the charitable trust issue.
22 Without conceding that it is a charity or that any of its
23 assets are subject to charitable limitations or even that it
24 is obligated to transfer the fair market value of its assets
25 to the foundation shareholders that are intended to serve as

1 charitable organizations, Premera has fashioned its proposal
2 to comply as if it were a charity or that its assets were
3 subject to charitable limitations.

4 Based upon its application and consistent with the
5 evidence we expect to be presented at this hearing, Premera
6 intends to transfer the fair market value of its assets to
7 the foundation shareholders as if it were required to do so
8 by law.

9 This approach has great advantages. In fact, it,
10 perhaps more than anything else in the proposal, has made it
11 possible for this proceeding to go forward as it has. If
12 Premera had selected a different approach, it may have
13 resulted in drawing out the conversion proceedings with, for
14 instance, proceedings to determine whether Premera is a
15 charity or its assets are subject to charitable limitations,
16 issues clearly within the purview of our Attorney General.

17 What this means in this proceeding is that the Staff
18 will hold Premera to the standard it set for itself by the
19 filing of this particular proposal, that the proposal, if
20 approved, will result in the transfer of the fair market
21 value of its assets upon dissolution to the foundation
22 shareholders.

23 Much of the reports and testimony goes to whether
24 Premera's proposal meets this standard. This does not mean
25 that the charitable trust issue will not come up during the

1 hearing. Whether or not Chapter 24.03 of the Washington
2 statutes or the Charitable Trust Doctrine or the Common Law
3 Cy Pres Doctrine or all of the above apply, it will be
4 discussed.

5 The Staff's consultants have, to some extent, in
6 analyzing various aspects of Premera's proposal relied upon
7 a rationale based upon charitable trust principals. This is
8 particularly apparent in the consultants' analysis of the
9 allocation of assets between the proposed Washington and
10 Alaska organizations as well as in that relating to whether
11 Premera's proposal will in fact deliver fair market value to
12 the foundation shareholders.

13 Of course, Premera has responded with testimony and
14 argument that contradicts the basis for the rationale and we
15 fully anticipate that Premera will continue to take issue
16 with use by the Staff's consultants of the rationale. But
17 the fact remains, Premera's proposal contemplates the
18 transfer of the fair market value of its assets upon
19 dissolution to the foundation shareholders and the Staff
20 will hold Premera to this standard.

21 In case there is any question, just as Premera does not
22 concede it is a charity, the Staff does not concede the
23 reverse, that Premera is not a charity or that its assets
24 are not subject to charitable limitations. The issue is not
25 proper for resolution in this proceeding and Premera's

1 filing successfully avoids the necessity for the
2 Commissioner to even consider making a determination on this
3 issue.

4 Although Premera may take the legal position that
5 suggests otherwise, by the form and structure of its
6 proposal, Premera has recognized that it owes its good
7 fortune to the citizens of Washington and Alaska.

8 Thank you, Commissioner.

9 JUDGE FINKLE: Thank you. Which of the Intervenors
10 will give openings at this time?

11 MS. HAMBURGER: Your Honor, my name is Eleanor
12 Hamburger from the Premera Watch Coalition and I will be the
13 first of the Intervenors to give an opening statement.

14 JUDGE FINKLE: And which other Intervenors expect to
15 give openings at this time?

16 MR. MADDEN: The Hospital Association, Your Honor.

17 MR. COOPERSMITH: And the Medical Association as
18 well.

19 JUDGE FINKLE: How long would the three of you
20 expect to take all total?

21 MS. HAMBURGER: My opening will be 10 to 15 minutes.

22 MR. MADDEN: Five to 10, 15.

23 MR. COOPERSMITH: And 10 to 15 as well.

24 JUDGE FINKLE: Why don't we go through the openings
25 from the Intervenors and then we will take a break.

1
2 OPENING STATEMENT

3 BY MS. HAMBURGER
4

5 MS. HAMBURGER: Thank you, Your Honor.

6 Good morning, Commissioner Kreidler and Judge Finkle,
7 Carol Sureau and Christina Beusch. My name is Eleanor
8 Hamburger. I'm from Columbia Legal Services and I represent
9 the Welfare Rights Organizing Coalition. I'm also the lead
10 attorney for the Premera Watch Coalition, which is a
11 coalition of consumer organizations, healthcare worker
12 organizations and provider organizations in Washington
13 State.

14 Premera's proposal to convert would be the first
15 healthcare conversion in our state and what happens with
16 Premera will affect thousands of healthcare consumers and
17 providers throughout the state and just as importantly will
18 establish a precedent for other potential conversions in the
19 future.

20 You will hear many reasons to disapprove the conversion
21 during the course of the proceeding, however two are most
22 essential. Number one, the conversion should be rejected
23 because the changes that could occur as a result of the
24 conversion could be harmful to Premera enrollees, providers
25 and the healthcare system in our state.

1 And number two, the conversion should be rejected
2 because it appears to be motivated by personal gain and
3 possible out-of-state expansion or acquisition all at the
4 expense of vulnerable Washington consumers and healthcare
5 providers.

6 During the next two weeks, you will hear from many types
7 of experts, tax specialists, accountants, antitrust experts,
8 economists, several expert lawyers, the former state
9 regulator and our health policy expert. But in this battle
10 of the experts, the fundamental question should not be lost.
11 Is the proposal good or bad for Premera enrollees,
12 providers, our state's health system and the public
13 generally? And if there is harm, are the reasons for
14 conversion enough to overcome it?

15 You will likely hear today from Gubby Barlow about
16 Premera's current initiative statement, however that's not
17 Premera's nonprofit mission as described in its articles of
18 incorporation and bylaws and that of its predecessor
19 organizations.

20 The nonprofit organizations that gave birth to
21 present-day Premera were dedicated to serving the healthcare
22 needs of our communities. In Western Washington the
23 nonprofit corporation that started it all, the Medical
24 Services Corporation of Spokane, was dedicated to serving
25 low-income, working families. That is the binding

1 historical purpose of Premera's predecessors and those
2 purposes should be continued by nonprofit Premera today.

3 Unfortunately, Premera ignores those purposes and it
4 maintains today that it is simply a commercial enterprise.
5 But though Premera ignores its nonprofit purposes, those
6 purposes existed and continue to remain binding.

7 So is the conversion good or bad for Premera enrollees,
8 providers, the health system and public interest in general?
9 The evidence will show that the conversion is harmful. Even
10 the short-term promises made by Premera that they eluded to
11 in the economic assurances will do little to alleviate the
12 harm that the conversion will cause.

13 We believe rates will increase. The OIC experts predict
14 that as a for-profit Premera will likely raise rates for its
15 enrollees in Eastern Washington in the individual and small
16 group markets.

17 Now, in Eastern Washington Premera controls over 80
18 percent of the business in these markets. The OIC experts
19 found that Premera has market power in those areas and if it
20 must increase its profits, it could do so by raising rates
21 above the normal market trend. Those working families in
22 Eastern Washington that Premera, as a nonprofit, was
23 dedicated to, it is those very people that will bear the
24 brunt of Premera's efforts to raise rates in response to
25 shareholders expectations. As many as 98,000 individuals

1 could see their premiums go up an additional eight to ten
2 percent above the normal premium increases. For many
3 working families that would simply be too much and they
4 would lose their health insurance.

5 My colleagues from the Washington State Medical
6 Association and the Washington State Hospital Association
7 will talk more - in more detail about the potential for cuts
8 to reimbursement rates for providers, but let me just point
9 out that those kinds of issues have direct impact on access
10 to care for thousands of consumers and also impacts the
11 amount of free and subsidized care that can be provided to
12 low-income people in the community served by those
13 providers.

14 Now, the impact on the health system could be - could be
15 quite dramatic. You will hear from some of Premera's
16 experts that Premera needs to convert so that they can
17 compete on a level playing field with that of other
18 for-profits. And that line has been used to justify
19 conversions in other states. It just doesn't apply here in
20 Washington.

21 The three big insurers that control most of the
22 Washington insurance market are all nonprofit. The Premera
23 conversion, on the other hand, would give Premera an
24 advantage that the other two lack and could possibly drive
25 the other two large nonprofit insurers in our state to

1 convert. The result would change the structure of
2 Washington health system forever. If Premera converts, the
3 precedent will be set and that threshold will be crossed and
4 there may be no going back to our current nonprofit system.

5 So why convert? Premera's experts claim that the
6 company doesn't need a reason to convert and its lawyers
7 have argued in their briefs that it doesn't have to give a
8 reason to convert, but that makes no sense. At the end of
9 this process, the public deserves and the law requires good
10 reason for this kind of dramatic change before it can be
11 approved.

12 Now, today you have heard them give three reasons for
13 conversion: To increase reserves, to fund information
14 technology and to have capital flexibility for growth.
15 However, these reasons just don't add up.

16 Premera maintains that it does not need to convert and
17 indeed the OIC experts project that the company will do just
18 fine without additional capital. Its reserves are adequate
19 and appropriate both for state statutory requirements and
20 the requirements set by the national Blue Cross and Blue
21 Shield Association.

22 Additionally, all the great things you may hear about
23 Premera's information technology they are all doing as a
24 nonprofit. Anything that they need to do they can continue
25 to implement as a nonprofit. And third, Premera, says it

1 strategic flexibility so it can grow, but that growth, which
2 will likely occur outside of Washington State - there is no
3 evidence that growth - that growth outside of the state will
4 be good for Premera's current enrollees or in Washington's
5 public interest.

6 The stated reasons just don't hold up. And it appears
7 to us that there may be other reasons motivating the company
8 to convert, one of them being a big payday for those who run
9 Premera. Conversions have typically resulted in huge
10 payouts to top executives who suddenly receive stock options
11 and compensation packages unheard of in the nonprofit
12 sector.

13 Postconversion in other states, the compensation of most
14 executives skyrocket. Under the proposed conversion, the
15 top executives of Premera will have their compensation
16 increased by more than 50 percent. Premera's board members
17 could see their compensation as much as triple.

18 And we only know the plans for compensation during the
19 first three years postconversion. After that, all bets are
20 off. Even more worrisome is that under the proposal the top
21 executives will have unusual benefits if the company is
22 taken over by another for-profit.

23 Typically in a takeover, a CEO is given lucrative
24 walkaway rights. Under Premera's proposal, if there is a
25 takeover, the CEO - the CEO, the CFO and all of the

1 executive vice-presidents will have the this special
2 benefit.

3 Now, why does this matter? Virtually every single Blue
4 Cross and Blue Shield company that converts has been gobbled
5 up by WellPoint or Anthem, the two large national for-profit
6 Blue plans, which they themselves are merging together into
7 a mega giant, for-profit healthcare entity.

8 The - Premera's proposed conversion package not only
9 gives management strong financial incentives to convert but
10 also to sell out to Anthem and WellPoint later on down the
11 road.

12 Now, you take that together with the consideration that
13 the initial public offering is expected to raise for Premera
14 about 100 to 150 million dollars - we know from recent
15 public reports that Premera has already spent nearly 31
16 million and counting in pursuit of conversion, nearly a
17 third of the capital it hopes to gain from the process.
18 Spending so much in pursuit of capital so that the company
19 can have some sort of nonspecific strategic flexibility
20 simply cannot be justified when the deal will cause harm to
21 Washington's health system.

22 The public interest demands that Premera stay nonprofit
23 and return to its original purposes. The public interest
24 demands that it serve working families throughout the state
25 to participate in Medicaid and the Basic Health Plan, to be

1 part of our state's healthcare solutions and not
2 contributing to our healthcare problems.

3 In Maryland after the Blue Cross/Blue Shield conversion
4 there was rejected, the legislature decided to hold the Blue
5 Cross/Blue Shield company accountable to its original
6 purposes and work to ensure a better, more
7 community-oriented, truly mission-driven health plan. We
8 can do the same thing here. In fact, we should do the same
9 thing here.

10 Based upon the evidence that will be presented to you,
11 at the end of this proceeding we will ask that conversion be
12 rejected unconditionally. Thank you.

13 JUDGE FINKLE: Thank you.

14
15 OPENING STATEMENT

16 BY MR. COOPERSMITH

17
18 MR. COOPERSMITH: Good morning, everyone. My name
19 is Jeff Coopersmith of the Coopersmith Health Law Group.
20 Our firm represents the Washington State Medical
21 Association, the largest physician group in the state and
22 the only physician group to represent physicians in all
23 specialties and in all counties in our state.

24 Commissioner, this case had its formal beginning almost
25 two years ago. Since that time, Premera has spent millions

1 of dollars, submitted tens of thousands of documents, filed
2 hundreds of motions and hired enough attorneys to - well,
3 hired enough attorneys to file hundreds of motions and take
4 nearly two years to bring a case to hearing.

5 But when you hack through all the motions and you slog
6 through all the expert reports and you weed out all the
7 arguments Premera makes for conversion, you will find
8 yourself in a clearing where all becomes clear, that the
9 dense thicket that was built around this case was designed
10 to keep you from seeing how truly simple this case actually
11 is.

12 Fundamentally this case is about, to use the legal term,
13 greed. And after you apply some scrutiny and after you
14 apply some common sense to Premera's explanation, we believe
15 the evidence will show that the only credible explanation
16 left for why Premera so desperately wants to become a
17 for-profit company is the desire of a few already highly
18 paid company executives to make even more money. Lots more
19 money.

20 Now, like in any case, you will hear conflicting
21 opinions and, like in any case, you will have to weigh the
22 credibility and the motivations of the witnesses. The WSMA
23 would like to take one very crucial example, that of patient
24 care. Yes, even the law figured out that if you are going
25 to talk about a healthcare insurer becoming for-profit, its

1 central concern ought to be the impact on access to care and
2 the affordability of coverage, the impact on patients.

3 Now, Premera has several witnesses that speak to this
4 subject, but as Premera's hearing brief shows, there is one
5 person whose conclusions Premera invokes over and over
6 again. And that person is an economist named Thomas
7 McCarthy.

8 Now, as you will hear when Dr. McCarthy testifies, to
9 reach his conclusions about our state, he didn't speak to a
10 single doctor or a single hospital or a single person -
11 patient in this state, nor did he speak to any group
12 representing any doctors, hospitals or patients in this
13 state. But he did reach a very firm conclusion. He is
14 certain that there is no difference when it comes to
15 healthcare between Eastern and Western Washington.

16 Now, WSMA will present testimony about how huge the
17 differences actually are, but frankly, my own seven-year-old
18 nephew knows when he has gone from Western to Eastern
19 Washington. My nephew knows that over there there are fewer
20 people and he knows that they are more spread out. And he
21 knows that it often takes longer to see essential people,
22 like a doctor or the good humor man.

23 Let's contrast Mr. McCarthy's credibility with that of
24 the two witnesses that the WSMA will present, Dr. Jeff
25 Collins and Bob Perna.

1 Dr. Collins has taken care of residents in Eastern
2 Washington for nearly 20 years. He treats them for heart
3 failure, liver failure, lung disease, diabetes, arthritis,
4 you name it. He, we believe, is the only physician in
5 Spokane to have been ranked in America's Best Doctors every
6 time that ranking system has been published.

7 He is someone who has taken care of thousands and
8 thousands of patients in his career. He sees them not only
9 in his clinic, but at the two large hospitals in Spokane.
10 He sees his patients at the prison where he goes to take
11 care of the healthcare needs of the inmates. And he
12 co-founded the first organization to serve people with AIDS
13 and, in fact, is a pioneer in the care of people afflicted
14 with HIV.

15 He is clearly someone who is caring and compassionate.
16 Dr. Collins has spent the last 12 years in leadership roles
17 in the Washington State Medical Association. He - and
18 culminating this year in his presidency of the organization.
19 And in those leader capacities, Commissioner, Dr. Collins
20 has traveled throughout the state. He has spoken to doctors
21 throughout this state.

22 He is very concerned about the severe stress that our
23 healthcare system is under, the struggle that patients have
24 to get quality care in this state and all too often, the
25 struggle that physicians have in giving those patients that

1 care.

2 Dr. Collins will testify about how difficult it is to
3 get an authorization from Premera sometimes for the tests
4 and the procedures that his patients need. Dr. Collins will
5 testify to how difficult it is to get a straight answer from
6 Premera on what is and isn't covered.

7 He will testify to how difficult it is for his Premera
8 patients to find out what medications they will be getting
9 and how much of those medications costs will be covered by
10 Premera. Dr. Collins will testify that it is difficult,
11 nearly impossible, to resolve a claims dispute with Premera
12 and nearly impossible to negotiate with Premera either.

13 His experience is that it is a take-it-or-leave-it
14 contract. And for too many of his colleagues in Eastern
15 Washington and through the state they find themselves in the
16 same predicament, you either take the Premera contract or
17 you leave it.

18 Well, can you leave the Premera contract?
19 For Dr. Collins, half - half of his private insurance
20 billings goes to Premera. The next leading source of
21 billings is one-fifth that size. How could Dr. Collins and
22 so many of his colleagues possibly turn away Premera?

23 Dr. Collins, of course, will recognize that many of the
24 problems that beset our healthcare system were not created
25 by Premera's proposed conversion. They already existed.

1 His concern is that the conversion would exacerbate the
2 existing problems and create new ones.

3 Bob Perna: Bob Perna has devoted 35 years to the
4 healthcare profession. He has seen the business side of the
5 profession in virtually - for virtually every player in the
6 system. He has worked, in fact, for the health insurance
7 industry. For the past 12 years, he has been with the WSMA
8 and has been the director of healthcare economics. And in
9 that capacity he is the key contact between the insurers and
10 doctors and the key contact between the association and
11 health insurers.

12 He will - he will testify as to the true nature of some
13 of Premera's competitors. He notes that Premera stated that
14 some of the so-called competitors for Premera are not even
15 full-service health insurance companies. Some of the
16 companies that Premera sites as competitors don't even offer
17 private insurance. And some of the companies that Premera
18 sites as competitors only offer private insurance in very
19 small portions of the state.

20 Mr. Perna will also testify to the escalating costs of
21 the education and training of physicians and to the
22 escalating costs of operating a practice and to the
23 escalating costs of new diagnostic and procedural tools that
24 are necessary to meet the demands of patients and to provide
25 them the very latest and best in quality care.

1 Now, he will also testify, as will Dr. Collins, to the
2 importance of what is known as provider reimbursement,
3 compensation to physicians for the services that they
4 provide. This is not a parochial interest. I trust it is
5 no revelation of a trade secret that you can't get access to
6 care unless you have access to physicians. It doesn't
7 matter what the affordability is of our coverage if there is
8 no one there to give you your care. And most of the WSMA
9 witnesses will talk about how hard it is to recruit and
10 retain physicians in this state because of the inadequate
11 reimbursement levels.

12 Now, Premera's witnesses: Mr. McCarthy and his
13 colleagues are as adamant about there being only one
14 healthcare marketplace in this state as they are in saying
15 that premiums will not increase as a result of conversion
16 and that compensation to physicians will not be decreased.
17 If that is the case, if they are that competent, then surely
18 their economic assurances can last longer than two years.

19 Why not make them five years in length? Ten years in
20 length? That would demonstrate, indeed, that premium
21 increases and provider reimbursement are off the table.

22 And Dr. Collins will testify to the impact of those
23 premium increases. The - Premera would love to have us
24 believe that there is somehow a difference between
25 physicians and their patients on premium increases. On the

1 contrary, they both see this issue the same way.

2 Dr. Collins will tell you that whenever premiums go up, it
3 means that his patients defer care. They can't afford it
4 and they don't come back in to see him until they get so
5 sick they can't - they don't have any other choice.

6 Mr. Perna will talk about the excess utilization that is
7 reported to him of emergency rooms, where people go to the
8 emergency rooms because what could have been handled in a
9 primary care setting has now become acute and they need to
10 get the care of an emergency room physician.

11 So this is not - and Premera would have you believe that
12 every time they have a premium increase - rather an increase
13 in physician payments, that results in a premium increase.
14 Well, the evidence will be to the contrary. The evidence
15 will show, for example, that just in the individual market
16 between 1999 and 2002 Premera policyholders experienced rate
17 increases totaling more than 90 percent.

18 Small group policy saw premiums of more than 50 percent
19 during the same period. I doubt that there are very many,
20 if any, practice groups in this state, any physician groups,
21 that saw increases in their payments of that nature.

22 So we need to take a closer look, apply that scrutiny
23 and common sense to this proposal and look at what Premera
24 has said. Take it at face value. It says - what are the
25 company arguments? First, that it needs to convert for

1 growth. But bigger is not necessarily better. And in
2 healthcare, bigger is often worse.

3 We just heard Premera state that one of the benefits of
4 growth is that they can spread the costs over a wider base.
5 You will hear testimony from the WSMA witnesses about just
6 what happened when Premera got a whole lot bigger in Eastern
7 Washington by acquiring MSC and the years and years of
8 disarray and confusion that that caused when MSC members
9 were now being refused care or refused coverage because
10 Premera's system couldn't recognize them and didn't honor
11 the payments that they had paid in for that care.

12 This is not about administrative efficiency. Often
13 bigger is clumsier and more bureaucratic and more
14 efficient - more inefficient. And even if growth in itself
15 were a virtue, then Premera's own numbers show that it grew
16 38 percent since 1999.

17 And interestingly, one of the OIC experts concludes that
18 the big growth that Premera wants to continue has already
19 happened here and that it would largely out of state.

20 Should the Washington State Office of the Insurance
21 Commissioner really be in the business of adding growth in
22 Arizona for Premera?

23 Reserves: Premera states that it has to convert in
24 order to improve its reserves, but Premera's own numbers
25 shows its reserves are growing. In 2002 they were at 406

1 percent of the requirement and one year later they are at
2 433 percent of the requirement.

3 Mr. Commissioner, in this case what is not said is as
4 important as what is being said. The CEO of Premera will
5 testify that to stand behind Premera's members healthcare
6 coverage, Premera must be financially sound. We agree with
7 Mr. Barlow.

8 What does financially sound have to do with the
9 conversion? Presumably, we will not be hearing Premera
10 argue that it is financially unsound now as a nonprofit.

11 Premera also asserts that it needs to invest in
12 infrastructure and new products. But listen to what you
13 won't hear. Premera never identifies anything, anything, it
14 would buy as a for-profit that they can't get as a
15 nonprofit.

16 One thing we do know that Premera just got is a complete
17 overhaul in its infrastructure and its products. It is
18 calls Dimensions. Premera says they paid 125 million
19 dollars for this. And Premera describes it as designed to
20 provide services at industry leading levels, that it was a
21 result of a major Premera initiative to redesign its entire
22 service model. So why is this conversion needed?

23 Competition: Premera's CEO says that, quote, "The
24 conversion will enable Premera to compete on a level playing
25 field," close quote. Well, Commissioner, in Eastern

1 Washington there is hardly anyone left on the playing field
2 but Premera. And if Premera really does believe in a level
3 playing field out there, perhaps it is willing to give
4 Regence its Blue Shield designation in Eastern Washington
5 and then let's see what real competition produces.

6 In Western Washington Premera largely divides the
7 playing field with Regence, into a lesser extent Group
8 Health. Well, Regence and Group Health are both nonprofits.
9 The largest for-profit insurer in the state is Aetna.
10 Aetna, the same company that Premera just beat out for the
11 prestige contract to cover Microsoft employees.

12 What level playing field is Premera really talking
13 about? When it comes to patient care, the medical director
14 of Premera says it costs money to develop programs for
15 patients, but then he goes on and talks about the care
16 facilitation, disease management programs, ones they just
17 implemented without the benefit of con- - of conversion.

18 What you also won't hear from Premera is that senior
19 management already has the highest paid health insurance
20 executives in the state. They stand to gain millions from
21 conversion and could gain millions more from a sale to an
22 out-of-state company.

23 Now, Premera abandoned the Medicaid and Healthy Options
24 market prior to this hearing, perhaps to remove the concern
25 that conversion would harm the poor. Premera abandoned

1 Medicare prior to this hearing, perhaps to remove the
2 concern that conversion would harm seniors.

3 Why not have Premera commit to not selling to an
4 out-of-state company? Prove its commitment to remain a
5 local and independent plan as it repeatedly states it wants
6 to be.

7 And why not have Premera take one more big issue off the
8 table? Why not have Premera abandon huge windfalls for
9 senior management and remove that concern as being the real
10 reason for this conversion?

11 Your Honor, early in this process the - Premera accused
12 the State Medical Association of being parochial and only
13 interested in - in provider reimbursement. Trust me when I
14 say that my clients have a lot better things to do with
15 their time and resources than to fight this conversion. I
16 don't have anything better to do with my time, but they have
17 a lot better things to do, like taking care of patients here
18 in this state. They have only done this out of necessity
19 because they recognize the threat that this proposal
20 presents.

21 We extended, at the very beginning of this process, an
22 invitation to the Premera senior executives to renounce in
23 writing and under oath that they would gain any personal
24 benefit from the conversion or possible subsequent sale. We
25 never heard back about that invitation.

1 Finally, let me just say a very brief word about the
2 Holding Company Act. The smart lawyers in this room will be
3 able to analyze that far better than I will. All I can tell
4 you is that essentially that Holding Company Act is very
5 similar to the rest of the insurance code that you have
6 taken the duty of - the oath of this office to uphold and
7 that you have done such a good job upholding since you took
8 office nearly four years ago.

9 The Holding Company Act is much like addressing the
10 insurance code. It is at heart about protecting the
11 consumer interest. It is about protecting the public
12 interest.

13 In this the defining moment of your tenure as Insurance
14 Commissioner, we will ask you to look at all of the evidence
15 in this case and at the conclusion of that presentation, the
16 Washington State Medical Association will then ask you to
17 reject unconditionally Premera's attempt to become a
18 for-profit company. Thank you.

19 JUDGE FINKLE: Thank you.

20
21 OPENING STATEMENT

22 BY MR. MADDEN

23
24 MR. MADDEN: Mr. Kreidler, Judge Finkle, Ms. Sureau,
25 Ms. Beusch, it is privilege to make some brief opening

1 remarks this morning on behalf of the Washington State
2 Hospital Association and the Association of Washington
3 Public Hospital Districts.

4 Combined, their membership represents nearly 100
5 hospitals in our state. And, as you will hear, Washington
6 hospitals who, in fact, founded the company that is now
7 Premera nearly 60 years ago, are strongly opposed to
8 Premera's proposed conversion because there is substantial
9 evidence in the form of both expert opinion and experiences
10 in other states to indicate that conversion to a for-profit
11 stock company will be harmful to the insurance buying public
12 and because there has been no clearly articulated legitimate
13 reason for conversion.

14 We will present evidence that conversion and changes -
15 and the changes in corporate behavior that of necessity
16 result from conversion are likely to adversely impact
17 healthcare providers and their patients and that because the
18 financial health of Washington hospitals is so precarious,
19 that any downstream shift be it in decreased reimbursements
20 or increased demand for uncompensated care even marginally
21 will have a serious adverse effect and will be likely to
22 cause harm to hospitals and their patients.

23 Premera, of course, has attempted to rebut the proof set
24 forth by the Staff and the Intervenors offering the
25 proverbial mountain of paper to persuade you that conversion

1 will not have any of the negative effects identified by your
2 staff and the Intervenor.

3 Commissioner, it will be your job at the end to
4 evaluate that evidence and to decide if there is sufficient
5 evidence to overcome the showing made by the Staff and the
6 Intervenor. And in this regard we want to outline for you
7 in this opening statement several reasons why we believe
8 Premera's case is not credible. First of all, Premera's
9 case does not pass what I call the no free lunch rule. You
10 know, we all know the saying there is no such thing as a
11 free lunch and I believe there isn't.

12 And I base the argument that Premera's proposal doesn't
13 pass the no free lunch rule on three key provisions, all of
14 which are advanced by Premera itself. First of all, Premera
15 as a nonprofit has an operating margin of one to two
16 percent, which its CEO says is a little slim for his - for
17 his state.

18 Premera has said that - both publicly and internally
19 that if it cannot convert, it has the means necessary to
20 continue to thrive as a nonprofit company. In other words,
21 that it can continue to grow, grow its business, address the
22 necessary technology and infrastructure, et cetera, albeit
23 perhaps at a slower pace than would be the case if
24 conversion were allowed.

25 And, finally, Premera has said that its corporate

1 behavior will not change after conversion because its
2 current management already runs the company with the same
3 bottom-line orientation that a for-profit stock company
4 would have.

5 So here we have a company whose management already has a
6 bottom-line orientation that is financially able to do
7 everything that it needs to do in order to grow and be
8 successful, but which is still operating at a one to two
9 percent margin. Now, we are going to add a shareholder
10 expectation of return on investment.

11 Premera has not told us how it will be able to improve
12 its operating margin without either increasing premiums,
13 lowering medical payments or getting out of less profitable
14 markets yet Premera confidently tells us that piling
15 investor profit expectations on top of its one to two
16 percent existing margin will not change anything about how
17 the company does business.

18 More pointedly, they claim that premiums will not go up
19 more the rate of medical inflation. Provider reimbursements
20 will not go down - or maybe after I heard them this morning
21 they actually didn't say that - and that the company will
22 not exit less profitable markets or use its market power to
23 maximize returns nor will it allow itself to become the
24 subject of a merger or acquisition.

25 I think it is your job as fact finder, Mr. Commissioner,

1 to evaluate the credibility of these claims. We submit to
2 you that you should be extremely skeptical about them, not
3 only because they violate the no free lunch rule or the
4 common sense test, but because they defy the experience of
5 other states where insurance commissioners have found that
6 adverse effects were likely to occur or they are
7 inconsistent with the experience in states where conversions
8 have been allowed and adverse effects have occurred. We
9 intend to present that evidence to you during this hearing.

10 Also in considering the credibility of Premera's claims
11 we think there is some other items of evidence which you
12 should consider which raise doubt about the voracity of
13 Premera's key claims. First, you should know that in the
14 year 2000 Premera told the legislature that it was not
15 considering converting and would commit to not convert for a
16 certain period of time if the legislature would not adopt
17 legislation that was proposed by your predecessor, yet a
18 year later Premera was well down the road to conversion.

19 Second, when it decided to convert, Premera acknowledged
20 internally that there would be a debate and perhaps even
21 litigation about whether the assets of the company were
22 impressed with a charitable trust. And while claiming that
23 it is not a charitable corporation, Premera's CEO told the
24 company's top managers that in the end it did not matter
25 whether Premera was charitable or not because under his

1 proposal, in Mr. Barlow's words, "The entire value of the
2 company would be conveyed for charitable purposes."

3 Furthermore, and as you know, Premera made a request of
4 the Attorney General to review its proposed distribution of
5 assets to the foundations under the Not-For-Profit
6 Corporation Act. And you will hear testimony from Premera's
7 own corporate law expert that the only basis for that
8 request is the proposition that Premera is a company with a
9 charitable purpose, otherwise the Attorney General has no
10 jurisdiction.

11 You will also hear evidence that in other contexts when
12 it has served its purposes, the company has allowed its
13 representatives to make the contrary assumption, that it is
14 charitable and that - and that furthermore Premera has
15 allowed your staff to allow - to rely on those
16 representations for material points in their review of this
17 proposal.

18 Now, however, when the regulators and interested groups
19 are raising concerns about whether the proposal will convey
20 fair market value to the public, Premera has adopted a new
21 position claiming that it has absolutely no obligation
22 whatsoever to convey any assets for the public benefit and
23 that instead it is merely making a gift of stock to
24 charitable foundations. Through its experts, Premera says,
25 in essence, this is a gift horse, don't examine it too

1 closely.

2 Well, Mr. Commissioner, as with the question of whether
3 New Premera will raise premiums or decrease reimbursements
4 or exit unprofitable markets or otherwise behave in ways
5 adverse to the interest of Washington consumers, Premera
6 cannot have it both ways. It cannot admit on the one hand
7 that it will have to satisfy investor expectations and then
8 not explain to you how it will do so without harming the
9 public.

10 And it cannot say on the one hand, for purposes of
11 obtaining favorable review by your staff or approval from
12 the AG, that it is charitable and then seek to avoid
13 vigorous review in this proceeding by claiming that it is
14 not.

15 Quite simply, Mr. Commissioner, we believe that when all
16 the evidence is in, as complex as it may be, if you subject
17 it to common sense evaluation, there will be no reason to
18 find that Premera has overcome the concerns raised by your
19 staff and the Intervenors. We will ask you, therefore, to
20 reject the proposed conversion transaction. Thank you.

21 JUDGE FINKLE: Thank you. Let's go ahead and take a
22 15-minute break.

23

24 (Brief recess.)

25

1 JUDGE FINKLE: Okay. We are ready for Premera's
2 first witness now. I should announce that there is a Honda
3 Element, 779 RVI, that is in a construction zone. You might
4 want to take notice of that. There is going to be
5 construction going on through the course of the proceeding,
6 as I understand it.

7 Please call your first witness.

8 MR. KELLY: Yes, good morning, and Premera will call
9 Sally Jewell as our first witness, please.

10 SALLY JEWELL, having been first duly
11 sworn by the Judge,
12 testified as follows:

13 JUDGE FINKLE: Please sit down.

14
15 DIRECT EXAMINATION

16
17 BY MR. KELLY:

18 Q Okay. And would you please your name, title and employer?

19 A My name is Sally Jewell. My title is Chief Operating
20 Officer and Executive Vice-President and my employer is REI,
21 Recreational Equipment --

22 Q And, for the record, what is your business address?

23 A My business address - mailing address is P.O. Box 1938
24 Sumner, Washington, 98390.

25 Q What is your relationship to Premera Blue Cross?

1 A I am an independent director of Premera and Premera Blue
2 Cross.

3 Q And you have served on those boards for how long?

4 A Nine years.

5 Q And for convenience, the members of each board are
6 identical; is that correct?

7 A That's correct.

8 Q Okay. So for convenience, I will just refer, if I may, to
9 "the board."

10 Do you serve on any committee of the board?

11 A Yes. Currently I serve as chair of the Governance Committee
12 and I also serve on the Audit and Compliance Committee.

13 Q And have you sat on other committees during the time of your
14 service at Premera?

15 A Yes. In my nine years on the board, I think I have served
16 on every committee currently or a prior committee with the
17 exception of the Quality Committee.

18 Q Okay. I would like to turn to your qualifications, if I
19 may. Could you summarize for us your educational
20 background?

21 A I have a bachelor's of science in mechanical engineering
22 from the University of Washington and in addition to that I
23 have supplemented that with business courses over the course
24 of my career.

25 Q Okay. And just give us a background of your business

1 career.

2 A I began my career upon graduation in 1978 as a mechanical
3 engineer working for Mobile Oil Corporation in Oklahoma and
4 in Colorado. I then transferred back to the Pacific
5 Northwest as a petroleum engineer for Rainier Bank in 1981
6 and followed Rainier bank through its succession of owners,
7 Security Pacific, ending up in that particular organization
8 as head of the commercial banking activities for the state
9 when it was acquired by Bank of America.

10 And at that point, I went to West One Bank where after a
11 year I was named president, CEO of West One Bank Washington,
12 and following that went to Washington Mutual where I headed
13 their commercial banking activities for four years and then
14 transferred to REI in 2000 to my present position.

15 Q Okay. Now, what other organizations are you active in by
16 boards and so forth?

17 A I'm currently, in addition to Premera, on the board of REI.
18 I have been on the board of REI for eight years. Also
19 served for six years on the board of Vista Corporation,
20 which is a New York Stock Exchange utility based in Spokane.

21 And then on the nonprofit side, I serve on the
22 University of Washington Board Regence. I am president of
23 the board of Mt. Fountain Lake (phonetic) Trust, an
24 organization I have served with for 13 years. And then I
25 have had a number of nonprofit board affiliations over the

1 years.

2 Q Very good.

3 Now, your prefiled direct and prefiled responsive
4 testimonies have been served and filed in this proceeding.
5 And for purposes formally of our record, do you adopt that
6 testimony?

7 A Yes, I do.

8 Q Okay.

9 MR. KELLY: And, Commissioner, as I said, the
10 prefiled direct testimony has been filed. It has been
11 marked as hearing Exhibit P-1 and Ms. Jewell's prefiled
12 response is P-2. And with her adoption of that testimony,
13 Premera now moves to admit those exhibits.

14 JUDGE FINKLE: Admitted.

15 Q (BY MR. KELLY) Now, has - I would like to ask a little bit
16 about the - the approach and considerations that the board
17 has taken over the years in regard to dealing with this need
18 for capital.

19 First of all, has the board periodically assessed the
20 issues surrounding capital levels during the time that you
21 have been on the board?

22 A Yes. As a matter of fact, from some of the earliest
23 meetings I recall attending at Premera the issue of capital
24 and whether the capital was sufficient for the company has
25 been a constant theme of discussion with the board.

1 Q And is it, in fact, the case that a company like Premera is
2 very capital-intensive in terms of its need for capital to
3 continue in existence and grow?

4 A Yes. And I think one of the challenges that Premera faces
5 is it is expensive to continue to keep one's services up to
6 speed with the regulations both on a federal and a state
7 level and multiple states with the complexity of the
8 provider networks and the membership and so on. And it is a
9 very capital-intensive business.

10 In addition to that, it is mandated by both the Blue
11 Cross/Blue Shield Association as well as the state offices
12 of the Insurance, that certain minimum levels of capital be
13 maintained for the health of the business. So those have
14 been - the board has been very conscious of those all along.

15 Q Okay. Now, let me turn your attention to about 1997. Did
16 the board retain an investment banking company to review
17 Premera's business structure as well as its financial and
18 capital position?

19 A Yes. I recall a very expensive board meeting in 1997. I
20 believe the consultants that came in were Goldman Sachs,
21 experts in the healthcare industry and capital in the
22 healthcare industry, and talked to us about what kind of
23 alternatives we might have over time for raising capital.

24 Q Okay. Was any decision made after that information?

25 A Well, one of the things that occurred prior to me joining

1 the board was an affiliation between MSC, headquartered in
2 Spokane, and Blue Cross of Washington/Alaska about an
3 affiliation. And one of the recommendations that I believe
4 came from that meeting in 1997 was to contemplate a formal
5 merger of those two entities so that the capital base could
6 be combined and so they could begin a process of
7 streamlining the systems to become more efficient and
8 effective in terms of both entities.

9 So I believe that that conclusion was reached at the
10 1997 meeting or shortly thereafter. And I believe that
11 merger formally occurred in 1998.

12 Q Okay. I would like to turn your attention to the late
13 1990s. What was the company focusing on doing at that time?

14 A In the late 1990s Premera, and probably it is safe to say
15 nearly all of the health insurers in the State of
16 Washington, were losing a lot of money. Premera had severe
17 strains on its financial capabilities. Much of that was due
18 to regulatory mandates in terms of patients and medical
19 underwriting and so on, that caused its medical loss ratios
20 to skyrocket and the company to lose tens of millions of
21 dollars.

22 So the board's first priority during that time was turn
23 the company around financially, to the extent it could,
24 exiting lines of business that were extremely unprofitable
25 and to return the company to financial health.

1 Q Okay. Now, with that return, did the company undertake new
2 innovative efforts, and if so, can you describe what they
3 were?

4 A We had many things going on in the late '90s. The company
5 was trying to address all of them. One was Y2K, which was a
6 very significant investment, not just for Premera but many
7 companies. Another was trying to address the upcoming HIIPA
8 requirements that were mandated across the country, very
9 expensive for all factors of the healthcare industry, while
10 also trying to address the needs of systems to meet the
11 future demands of - of its insured population and its
12 providers. So Premera was attempting to invest in each of
13 those aspects during the time that was very tight
14 financially.

15 Q There has been some discussion about Dimensions. Did that
16 develop at about that time as a result of the efforts of
17 Premera?

18 A Dimensions' precursor was called Business and Systems
19 Transformation or the BEST project. That project was many
20 years in the formation, because these are very expensive,
21 ongoing analyses that - trying to determine whether your
22 baseline systems are going to be adequate to support your
23 company in the future.

24 So, yes, the discussions around the Business and Systems
25 Transformation really began to take off once Y2K was behind

1 the company. And those programs, the Dimensions suite of
2 products, has been rolled out just in the last year to
3 increase --

4 Q Is it accurate to say good as it is, Dimensions is not the
5 final word in healthcare insurance delivery?

6 A That is very good to say. I think it is clear that
7 healthcare insurance delivery is evolving. It is a
8 challenge across the country for companies to maintain their
9 systems and try to be consistent with providers to make it
10 easy for providers to process claims and for payment. And
11 Dimensions is a step in that direction, but it is by no
12 means the last step.

13 Q Now, there was some talk also in your testimony about growth
14 of Premera. With each new customer, what implication does
15 that have in terms of capital needs and capital
16 requirements?

17 A Well, I think one of the frustrations we have had is to the
18 degree that Premera is successful in attracting new members,
19 it adds to the need for capital. And so the board has
20 consistently looked at the company's prospects for growth.
21 Growth comes by attracting members to Premera and every
22 member we add to Premera requires capital.

23 So the board felt it very important that we find a
24 source of capital to support this growth otherwise what you
25 end up doing is perhaps reducing your membership in one area

1 to increase it in another area. And we didn't feel that
2 that was optimal.

3 Q Okay. Now in 2001, did the board begin an in-depth review
4 of the alternatives for enhancing capital?

5 A Yes. I believe it was August of 2001 where we really began
6 to dig in on the various alternatives that were available.
7 And we had a retreat in September of 2001, which, of course,
8 no one in Premera will forget because we were scheduled to
9 fly back on 9-11 from Alaska. And we spent a fair amount of
10 unscheduled time together obviously talking about the things
11 the nation was talking about, but also it gave an
12 opportunity to reflect on the important decisions that we
13 had been contemplating.

14 Q And in that September time period did the board conclude
15 that the concept of conversion had merit?

16 A Yes, we did.

17 Q And were there any additional - what additional efforts were
18 then followed up on in light of that recognition?

19 A Well, we had a number of board meetings and special board
20 meetings and preparation materials to help us understand
21 what the alternatives might be to Premera, what the process
22 might be involved in a conversion, how we might assure
23 ourselves that the company would continue to move forward in
24 its business as we pursued these alternatives.

25 So, I mean, I would say I have never seen a process more

1 diligent in my experience in boards or management as this
2 process. I think this board was very well-prepared for many
3 years in advance for understanding what kinds of
4 alternatives might be available to it. And we had
5 tremendous expertise available to us to help us make a smart
6 decision.

7 Q Okay. And that decision was finally made in May of 2002?

8 A That's correct.

9 Q Okay. Can you tell the Commissioner what other alternative
10 means of raising capital - let me rephrase the question.

11 Did the board raise - or look at alternative means of
12 raising capital in addition to seeking it through the equity
13 markets in conversion?

14 A Yes, we did. In fact, really the concept of conversion
15 didn't come up until kind of the time frame we are talking
16 about. We looked - I mean, I spent 19 years in commercial
17 banking. We looked at alternatives of financing
18 transactions.

19 One of the challenges - and I'm sure that Mr. Marquardt,
20 when he testifies, will explain some of the complexities
21 behind the Blue Cross/Blue Shield Association to raise
22 capital, but there are only a handful of vehicles that would
23 actually support capital using that instrument.

24 My recollection, it's subordinated debt upon the surplus
25 note and only a portion of that might be for raising

1 capital. So there really wasn't an alternative. And if you
2 think about that, a healthy company needs a blend of debt
3 and equity to grow and you can't just go to the debt market
4 and expect to solve a long-term capital problem. So we did
5 look at that.

6 We also talked about merger partners and things like
7 that, trying to explore what kind of alternatives we might
8 have to solve the capital.

9 Q Well, let me ask you about a merger. What were the
10 considerations that led the board to conclude - trying a
11 merger, even if feasible, was not where the company should
12 be going?

13 A Well, the logical merger had already occurred and that was
14 with Blue Cross Washington/Alaska and MSC. Within the
15 state, so within the purview of this Insurance Commissioner,
16 I think there would be issues potentially arising in terms
17 of antitrust.

18 If you look outside the state, there would be the
19 complexities of regulatory approvals from multiple states.
20 And I think if you look at the affiliation of Regence and
21 the Illinois plans and then the sort of backing away of that
22 affiliation, it gave us a sense of the complexities of those
23 things. And, you know, we were well aware of the number of
24 transactions across the country and both how they worked and
25 whether they were, in fact, working.

1 And then, of course, any other kind of conversion with,
2 say, a for-profit entity or a merger would have required a
3 conversion anyway. So there wasn't a simple solution
4 involving banding together with another party that we could
5 evaluate.

6 Q Okay. And then what about the sale of fixed assets or
7 operating units, was that considered and what were the
8 limitations on that?

9 A Well, in fact, the 125 million that was referenced earlier
10 in terms of the investment in Dimensions we did partially in
11 a sale lease-back transaction. I believe the lender was
12 General Electric. That was done in part to reduce the
13 impact on the risk-based capital calculation. That's an
14 operating system for the company. It's required for the
15 company to provides its services.

16 And that, in essence, is similar to all the assets of
17 Premera. They are in the company to provide, you know, the
18 support that the company needs to do its business. It is
19 the buildings, it is the computers and the infrastructure.
20 So while you could leverage those using the subordinated
21 debt surplus notes to get a little bit, it is not a smart
22 business practice, in my opinion.

23 Q It is certainly nothing for the long-term future?

24 A Not - no.

25 Q So those - you evaluated, then - the board fully - the

1 alternatives that it might consider other than the equity
2 markets?

3 A Yes, we did.

4 Q Having decided to access the equity markets, what will that
5 access do or permit Premera to do?

6 A Well, there is a couple of things. Most importantly, what
7 it does is it gives Premera access to capital in the outside
8 market, sufficient to fund its growth. So if Premera is
9 successful as a business and growing in the states of
10 Washington and Alaska and other markets and we are able to
11 add more members to leverage our infrastructure and become
12 more efficient, the market will view that as a positive and
13 we will be able to go to the market for additional capital
14 to support that growth, not just in an IPO, but in
15 subsequent public offerings providing the company shows the
16 market it has the ability to put their money to good use.

17 Q And that has benefits, I take it, for the members and for
18 the insurance buying public?

19 A I believe it has great benefit to them. Right now there is
20 no way to get outside capital into the company. And so if
21 Premera doesn't have access to outside capital, it is
22 limited in its ability to grow. It can either grow by
23 profitability and retained earnings. And as has been talked
24 about by some of the prior testimony, with a very slim
25 operating margin, that's not going to support growth very

1 quickly.

2 So the public markets are really the only place Premera
3 can go to get capital in a way that supports the members of
4 the market and the provider community. I don't think the
5 providers would stand to be reimbursed less. In fact, we
6 have heard some testimony to that effect. And they have a
7 business to run as well.

8 So capital markets I think will find Premera attractive
9 because it is a growing company. It is a company that has
10 shown innovation. And I believe that it is a company that
11 the market will say we will be able to become more efficient
12 over time by growing, using the infrastructure that it has
13 put in place.

14 Q Now, because of the structure that Premera proposed for the
15 conversion, was there another additional benefit to this
16 conversion that you think is important?

17 A There is a huge benefit. 100 percent of the stock of
18 Premera at conversion will go to the foundation shareholder.
19 And as the foundation shareholders in Washington and Alaska
20 sell that stock position down over time, it will raise a
21 tremendous amount of money to support the charitable
22 purposes of those two foundations.

23 I'm on the board of the University of Washington, as I
24 mentioned. The UW provides a lion's share of indigent care
25 in King County through both Harborview and the University of

1 Washington Medical Center. We are up close and personal
2 with the unmet healthcare needs of the citizens of our
3 state. And it is something that I think we are all
4 concerned about.

5 Mr. Coopersmith talked about some of the problems that
6 are inherent in the whole healthcare system right now and I
7 think they are immense. Unlocking the value of Premera into
8 foundations to help some of those intractable problems is
9 huge.

10 I spent seven years on the board of the YWCA of Seattle,
11 King County, Snohomish County. The YWCA is regularly
12 dealing with indigent patients who are released from
13 Harborview, typically homeless women with no place to go.
14 Those are the kinds of problems that are out there that a
15 charitable foundation can very much help to support.

16 So as a board member, as I became familiar with how
17 these kinds of transactions might occur. I felt that the
18 concept of a foundation shareholder where 100 percent of the
19 stock would be transferred was a very elegant solution to
20 helping the citizens of this state win, helping the members
21 win and helping the providers win.

22 Q Okay. Now, some people ask this question: I think it was
23 raised in the opening. Premera is not currently in crisis
24 so is there really a compelling business case for
25 conversion? What is your response and your response to the

1 board?

2 A When a company is in crisis, it has very limited options.
3 Having been in the banking industry and seeing banks go
4 through crisis, their options are very limited. The
5 decisions are made for them and it is typically not in the
6 best interest of any of their stakeholders.

7 Premera is a strong and viable company. It has got a
8 superb management team. It has got a management team that
9 this board believes can take the company into the future in
10 this complex world of health insurance. And this is the
11 time to convert. When you are in crisis is not the right
12 time to convert. And one of our experts - I think it was
13 Bank of America Securities - stated just that. That the
14 best time for a company to consider raising capital is when
15 it is strong.

16 Q Okay. Now, you testified in your prefile and today that it
17 was the board's decision, not management's, to make this
18 proposal for conversion. So, in your view, was your
19 decision making in way motivated by a desire to enhance
20 executive compensation?

21 A Absolutely not. I think this board has been extremely
22 diligent in ensuring that executive comp is fair and is
23 reflective of the competitive marketplace for the
24 individuals that serve Premera.

25 And you will be hearing from Pat Fahey, who chairs our

1 compensation committee, a little bit later on the diligence
2 that the board goes through. I have been involved in those
3 processes. I am very sensitive to the issue of executive
4 compensation and if I thought for a minute that there was
5 any personal motivation on the part of the executives here,
6 I would not support it. That is absolutely not part of our
7 motivation whatsoever.

8 Q Will there be any impact from the conversion on the board's
9 compensation philosophy in the future?

10 A No, the board's compensation philosophy has been that we
11 will compensate the executives of Premera consistent with
12 the - the pool of people that we would need to recruit from
13 to replace them, and that is both nonprofit and for-profit
14 health insurers around the nation. And that is a pool that
15 we look at and that will be the same pool that we look at
16 going forward. It will certainly include nonprofits as well
17 as public companies.

18 Q Let's turn now to the benefits of the conversion to
19 Premera's subscribers. In your view, how will the
20 conversion help Premera's subscribers?

21 A Premera will be able to support the needs of its subscribers
22 by having sufficient capital to invest in the kinds of tools
23 that are necessary to support their - their desires.

24 As times goes on, as an employer myself, and as a health
25 plan consumer, I think it is pretty clear that people are -

1 especially businesses - are looking for additional choices
2 in how they structure their health plans. The kinds of
3 investments Premera has made in Dimensions have begun to
4 address the interest that the subscribers have to that.

5 So I think also having the strong and healthy capital
6 position will enable Premera to invest in some subscriber
7 communities that may not be immediately profitable to the
8 company but over time will help spread the cost of its
9 infrastructure to make the organization more efficient.

10 So I think over the long pull, having the flexibility to
11 add members and subscribers to Premera will be a very
12 positive thing for those who currently have their health
13 insurance with Premera.

14 Q The Intervenor's testimony asserts that for-profit
15 conversions in healthcare corporations tend to stop serving
16 the interests of their customers, they claim, in their
17 communities and instead serve some other narrower interests.

18 How do you respond to that?

19 A Well, I - I'm frustrated by the - by the speculation that I
20 read in the Intervenor's testimony. I don't think there is
21 any evidence to suggest that. No business survives by
22 isolating the interests of its shareholders. A business
23 survives by serving the interests of its broad
24 constituents. That involves in this case making sure that
25 the subscribers are getting adequate healthcare, that the

1 providers feel that they have - they are getting reimbursed
2 in a timely and a fair way and the communities feel
3 supported.

4 And if those things are not at play, no public company
5 will survive. You have got to be able to serve the interest
6 of your constituents in order to be an effective business,
7 period.

8 Q Okay. Now, I would like you to take look at Premera's
9 Exhibit P-3. And I think I gave you a small notebook that
10 contains that document. You may want to refer to it. This
11 is a study in the New England Journal of Medicine by
12 Schneider, Zaslavsky and Epstein. It is entitled, quote,
13 "Use of High-Cost Operative Procedures by Medicare
14 Beneficiaries Enrolled in For-Profit and Not-For-Profit
15 Health Plans." And it came out in January of 2004.

16 Ms. Jewell, have you an opportunity to read this study?

17 A Yes, I have.

18 Q And it was attached to your prefiled response, was it not?

19 A Yes.

20 Q Okay. Because of the time limitations, let me just read
21 this quote, which is from the conclusion at Page 143 and ask
22 you whether you agree with it. The conclusion was, quote,
23 "Contrary to our expectations about the likely effects of
24 financial incentives, the rates of use of high cost
25 operative procedures were not lower among beneficiaries

1 enrolled in for-profit health plans than among those
2 enrolled in not-for-profit health plans." I think I read
3 that correctly.

4 A Yes.

5 Q Do you agree with that conclusion?

6 A I do agree with that conclusion. And I would encourage the
7 Commissioner to put on reading glasses because it is very
8 small font, but to read this article because, in fact, a
9 number of the conclusions here show the opposite.

10 Q Okay.

11 MR. KELLY: I would like to move to admit Exhibit
12 P-3.

13 MS. DeLEON: No objection.

14 MR. MADDEN: No objection.

15 JUDGE FINKLE: Admitted.

16 Q (BY MR. KELLY) Do you have, Ms. Jewell, any final comments
17 related to this issue of dealing with unmet healthcare
18 needs?

19 A Yes, I do. I have been immersed in thinking about this
20 conversion for sometime now. I consider myself a devoted
21 member of this community and a devoted volunteer to this
22 community. The prospects of unlocking the value of this
23 company through 100 of the stock going to the foundations in
24 Washington and Alaska I called earlier an elegant solution.
25 I think it could make an amazing difference if leveraged

1 effectively by those foundations in addressing many of the
2 challenges that we are feeling as a state and are being felt
3 by states across the country as we endure the ongoing
4 healthcare challenges; the aging baby boom demographic, the
5 young generation coming up behind it in the child-bearing
6 years, the cost of healthcare.

7 These are very difficult solutions. And to, you know,
8 look at the kind of value, the numbers that were kicked
9 around by the state's consultants, half a billion dollars or
10 more, to help address this I think is huge. And I think it
11 is something, as a director of Premera during this time of
12 conversion, I would be immensely proud of, proud to have
13 been a part of. And I think it would be a shame to see it
14 not occur.

15 I really do believe this is in the best interest of the
16 subscribers, of the providers, of the hospitals, of the
17 employers and the citizens of the states of Washington and
18 Alaska. And I would not be before you making this testimony
19 if I did not believe in my heart of hearts that this is the
20 right thing to do.

21 Q Very good. Thank you.

22 MR. KELLY: Those are all the questions I have. If
23 the attorneys or the Commissioner staff have any questions,
24 please go ahead and do so.

25 MS. DeLEON: Thank you.

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CROSS-EXAMINATION

BY MS. deLEON:

Q Good morning, Ms. Jewell.

A Good morning.

Q My name is Melanie deLeon. I'm an Assistant Attorney
General. I just have a few questions for you.

You have a background in banking; is that correct?

A That's correct.

Q Have you ever participated in the management of a health
insurer such as Premera?

A No.

Q Okay. Have you ever participated in a conversion
transaction such like this before?

A Nothing like this, no.

Q You have been on the board since 1995; is that correct?

A That's correct.

Q And you are a member of the Audit and Compliance Committee?

A Yes, I am.

Q Could you give us a brief synopsis of what that committee
does?

A Yes. The Audit and Compliance Committee is made up entirely
of independent directors. We review the external audits,

1 the internal audits of the company. We have been very
2 diligent in staying up to speed on the emerging requirements
3 for board of directors and the functions of audit
4 committees. We have a charter that is consistent with those
5 parameters.

6 We review compliance by the company with the rules and
7 regulations. We meet with the independent compliance
8 officer of Premera. We meet with the compliance officer of
9 Premera independently of the rest of management in executive
10 session.

11 You will be hearing from the chair of that committee,
12 Rick Fox, a little bit later on with more details on what
13 the committee work entails, but it is a very in-depth review
14 of how the company is run both from an audit standpoint and
15 a compliance standpoint to ensure it is keeping up with all
16 of the various rules and regulations.

17 Q I understand that you - during your testimony you said that
18 Premera was a financially sound company; is that correct?

19 A That's correct.

20 Q Would Premera continue to be a financially sound company if
21 the conversion was not approved?

22 A We would work very hard to ensure as a board of directors
23 that it remained financially sound. There are times during
24 my tenure as a board member when Premera's financial
25 soundness was in question and that was in the late '90s, as

1 referenced earlier.

2 Should that kind of a circumstance occur again and
3 should Premera be in a situation as we were back then when
4 we were on the early warning for low capital by the Blue
5 Cross/Blue Shield Association, I would worry about the
6 financial soundness of Premera and our ability to - to take
7 that kind of financial strain. So having been there and
8 having felt the constraints of the inability to raise
9 capital on the outside, I would not want to be caught in
10 that position again.

11 Q Isn't it true that Premera's minimal levels of capital meet
12 the statutory requirements and the Blue Cross/Blue Shield
13 Association's requirements?

14 A They do meet those requirements. If you look at the line up
15 of the Blue Cross/Blue Shield licensees, we are, I think,
16 fourth the from the bottom of the insurers. Our largest
17 competitor in that association in this state has capital in
18 excess of 500 percent. So, yes, we do meet the minimum
19 requirements, but there is not a wiggle room. And as
20 Premera grows, we run the risk of bumping into those
21 requirements.

22 Q You testified that with every new customer that adds the
23 need for capital for Premera; is that correct?

24 A That's correct.

25 Q So this would be a never-ending story then? With growth

1 comes more and more need for capital?

2 A That's correct.

3 I might point out, if I may, that from being a banker -
4 a commercial banker for many years, that is a common issue
5 with companies. They must have sufficient capital to grow.
6 If the company grows too fast - fast, it is always risky.

7 Q I also believe that you testified that without the
8 conversion Premera could still grow albeit slower?

9 A That's correct, providing it maintain the kinds of operating
10 margins it has right now. But as I mentioned before, if
11 there were risks to that, which could occur for a variety of
12 reasons, then it would constrain the company's ability to
13 grow or perhaps its ability to serve its current subscriber
14 base.

15 Q If the conversion is disapproved, would Premera have to
16 slash any products or services that you know of?

17 A Premera would have to examine its products and services and
18 would, perhaps, have to consider trade-offs as to whether it
19 wanted to remain in all of the lines of business that it is
20 in or whether it would want to favor one line of business
21 over another just from a margin standpoint to ensure that it
22 had adequate capital to grow. So it may have to make some
23 difficult decisions as opposed to having the ability to
24 support a broader array of business lines.

25 Q In deciding to convert, the board said one of the goals was

1 to preserve the company's independence; is that correct?

2 A That's correct.

3 Q Did the board conclude that this would be best for
4 policyholders and membership?

5 A I believe it would be. As I stated at the beginning of my
6 testimony, I have been in the banking industry. I have been
7 through many mergers and acquisitions, both being bought and
8 doing the buying. I believe that Premera has an
9 exceptionally strong and ethical management team.

10 I also believe that it has made the kinds of investments
11 that are going to position it well for growth in the future.
12 The Microsoft account was referenced. They are not an easy
13 account to support. When you put that many - tens of
14 thousands of members onto a system, it enables you to spread
15 the cost of that system over that many more members.

16 I believe this management team, the systems, the
17 infrastructure has the potential to grow. I was part of the
18 Washington Mutual organization for four years when it grew
19 almost ten-fold. It is headquartered in the State of
20 Washington. It is run by very smart people. I see the kind
21 of caliber and ethics in the people on this team that I
22 worked with in that team. And I would love to see the
23 company headquartered here, growing here and serving the
24 interests of the subscribers and members here.

25 Q Did the board consider approaching the Blue Cross/Blue

1 Shield Association in May 2002 when it decided to convert?

2 A I will have to defer to Gubby Barlow for specifics on dates.
3 I know that we had been informed all along as a board that
4 Premera has been in regular touch with the Blue Cross/Blue
5 Shield Association, but I'm not aware of the specific dates
6 that those meetings took place.

7 Q As a board member, to your knowledge, is Premera planning to
8 be acquired in the next five years?

9 A No.

10 Q Okay. How about in the next ten years?

11 A Premera has no plans to be acquired. Premera has plans to
12 be an independent company, to have the flexibility to grow
13 its business. And this board and this management team have
14 no interest being acquired.

15 Q Mr. Kelly read from Exhibit P-3 and I have that in front of
16 me. I would like to point to Page 146. It says, "The
17 characteristics of the health plans, that the for-profits
18 health plans in our study had a lower total number of
19 enrollees per plan and a lower number of Medicare enrollees
20 per plan than the not-for-profit plans and they were more
21 likely to be structured as independent practice associations
22 and to have been in operation for a shorter period of time
23 than the not-for-profit plans;" is that correct?

24 A That's what it says.

25 Q How do you, then, based upon that compare that to Premera?

1 A Well --

2 Q It was a very large healthcare insurer.

3 A I think they are stating the facts of their statistical
4 sample. I don't think it changes the conclusions of their
5 study at all in the way I read it. I didn't read that as
6 problematic any way.

7 Q Okay. It also said that "Their conclusions" - that "Their
8 results were somewhat counterintuitive and that leaders --

9 MR. KELLY: What page are we on?

10 MS. deLEON: 148, second column, about halfway down.

11 Q (BY MS. deLEON) -- "leaders of for-profit plans may focus
12 primarily on obtaining price discounts or trimming ancillary
13 services rather than on reducing the number of procedures
14 itself."

15 Do you believe that would be true as well?

16 A I think as I read this report there were assumptions that
17 these researchers had going in. They said the results were
18 counterintuitive. I believe it is somewhat similar to what
19 I'm sensing in the Intervenor's testimony, that they think
20 that being for-profit is going to reduce the level of care
21 or reduce the use of these high costs operative procedures,
22 but, in fact, the results were the opposite.

23 So I think that is the reference they are making to it
24 being counterintuitive. There is an assumption I think
25 people make that a not-for-profit plan is going to be more

1 inclined to support care than a for-profit plan when in
2 reality a for-profit and nonprofit, you still have to run a
3 viable operation which has a positive fund balance. If you
4 are not-profit or for-profit and you do procedures that you
5 are not able to cover your costs for, then you go out of
6 business.

7 So I think the fact that these researchers found it was
8 counterintuitive is very helpful in terms of thinking
9 through why folks like the Intervenors feel there will be
10 problems when, in fact, it is proven in this study that
11 there weren't problems between the for-profits and the
12 nonprofits. I found comfort in this.

13 MS. DeLEON: We have no other questions.

14 JUDGE FINKLE: Intervenors?

15 MR. MADDEN: Thank you.

16
17 CROSS-EXAMINATION

18
19 BY MR. MADDEN:

20 Q Ms. Jewell, I'm Mike Madden. I represent the Hospital
21 Associations. Let me ask you --

22 JUDGE FINKLE: Excuse me. I think you are going to
23 need to pull your mic - that is the network, but the other
24 mic closer.

25 MR. MADDEN: I have never had so many microphones to

1 deal with. Is that better?

2 JUDGE FINKLE: I believe so. Thank you.

3 Q (BY MR. MADDEN) Ms. Jewell, when was it that the Premera
4 board first heard about conversion to for-profit status as a
5 potential mechanism to deal with this perceived need to -
6 for additional capital?

7 A My recollection, the first time we talked about it was in
8 the August 2001 board meeting, at least in any kind of
9 depth.

10 Q Mm-hmm. Did you hear about it as an option from the Goldman
11 Sachs firm before that?

12 A I think in broad terms that there were, you know, nonprofits
13 and for-profits and public companies and so on.

14 Q And how far back was it that the board heard that
15 information?

16 A I don't recall specifically which meetings they might have
17 brought it up, but really the first time it was considered
18 in any depth was in 2001. You know, we examined the capital
19 structures of a variety of different firms. We looked at
20 capital structures of other nonprofit blues, the challenges
21 of other plans, who the competitors were out there. But
22 there wasn't any serious discussion on conversion or how
23 that might be structured until 2001.

24 Q And at the time in the late '90s when the company was
25 experiencing financial difficulty, did you hear from Goldman

1 Sachs at that time that while conversion was an option for
2 Blue plans such as Premera Blue Cross, that the financial
3 condition of the company at that time would not make it
4 attractive to Wall Street investors?

5 A I don't recall specifically Goldman Sachs drawing that
6 conclusion. I think that it was very clear to the board
7 that we had a priority and that was getting the financial
8 house in order for Premera so that's what we concentrated on
9 doing during that time frame.

10 Q Not to belabor the point, but did you hear from Goldman
11 Sachs or management or otherwise as a member of the board
12 that the company's financial health in the late '90s would
13 not make it an attractive conversion candidate?

14 A I don't recall specifically whether that conclusion was
15 drawn by Goldman Sachs or not. We had a lot of meetings.

16 Q My question, just to be clear, was not limited to Goldman
17 Sachs.

18 A And I don't recall specifically that - that conclusion.

19 Q All right. You said that essentially any growth, even
20 adding one more subscriber, requires additional capital;
21 correct?

22 A Net growth. If you one come in and one go out, that's -
23 that wouldn't apply.

24 Q Thank you.

25 You said that in - in its current configuration that

1 there are risks to the company if growth comes too fast;
2 correct?

3 A That's correct.

4 Q Okay. Tell me what would constitute growth coming too fast.

5 A Well, if we were to grow the number of subscribers - if a
6 substantial health insurer in the state were to go out of
7 business and they were to seek the transfer to Premera, for
8 example, that growth might impact our capital ratios
9 sufficient that we were back on early warning with the Blue
10 Cross/Blue Shield Association. Then, you know, we would
11 have to perhaps turn our focus to capital raising.

12 Q You criticized us earlier for speculating. Aren't you
13 speculating at this time?

14 A I don't think so.

15 Q You think that there is a health carrier in Washington that
16 is in danger of going under whose business Premera might be
17 able to acquire?

18 A No. You asked me for an example. I gave you an example.
19 If Premera were successful in landing several major accounts
20 in the State of Washington, that would have an impact on its
21 capital position.

22 Q Are there risks in going into the equity markets?

23 A Can you help me understand what kind of risks you might be
24 referring to.

25 Q Sure. Your IPO doesn't sell for what you anticipate.

1 A Yes.

2 Q Prior to making the decision to convert, what steps did the
3 board take to determine, as you have said in your prefile
4 testimony, that Premera is not and never was a corporation
5 with a charitable purpose?

6 A My understanding as a member of the board is Premera was
7 organized as a not-for-profit, not as a charity, so there
8 was never a question of whether or not Premera was a
9 charity. I have been on a number of charitable organization
10 boards. They are very different than this company.

11 Q I think we understand your understanding. My question,
12 however, was what steps did the board take in order to make
13 that determination?

14 A The board met with lawyers from outside of our of - of our
15 company lawyers who were experts on Blue plans and the laws
16 surrounding Blue plans. They reviewed in detail with us the
17 options that we had as - at Premera. They talked about the
18 alternatives available. They talked about what had happened
19 with other Blue plans in other states.

20 They reviewed with us our alternatives and we relied on
21 their representations of Premera's structure and its options
22 to assess the direction we might be going forward.

23 Q I see. Are you saying, then, that Premera - that Premera's
24 board engaged independent counsel to examine whether Premera
25 is or ever was a charitable corporation?

1 MR. KELLY: I will object. I really think counsel
2 is arguing with this witness. I don't think that's
3 appropriate here.

4 JUDGE FINKLE: Overruled.

5 MR. KELLY: You can answer.

6 THE WITNESS: What does that mean?

7 JUDGE FINKLE: If I overrule an objection, you go
8 ahead and answer the question, please.

9 THE WITNESS: Okay.

10 A I don't specifically recall that the outside lawyers - Saul
11 and Cromwell (phonetic) were one of the firms that advised
12 the board - talked specifically about the organization of
13 Premera as a charitable or not charitable. They talked
14 about our alternatives relative to a conversion and how that
15 compared to other Blues, so I do not recall a specific
16 discussion about our nonprofit nature occurring in that - in
17 that - those comments.

18 Q (BY MR. MADDEN) Is it fair to say company management said
19 you weren't a charitable corporation and the board accepted
20 that?

21 A No, that's not fair to say. I don't think the board ever
22 assumed that the company it was supporting as board members
23 was a charitable organization.

24 Q Was the board informed, nevertheless, that in connection
25 with other conversion efforts there have been disputes about

1 whether Blue plans were charitable corporations?

2 A We were briefed on the ongoing discussions of Blue plans
3 that were going through conversion. I don't recall the
4 specific details of those plans. Each one of them had a
5 different set of circumstances and I'm not familiar with the
6 details of any of them.

7 Q Okay. Let me try one more time. Was the board informed
8 that there had in connection with other conversion efforts
9 been disputes about whether the Blue plans involved were
10 charitable?

11 A I don't recall specific discussions about whether the Blue
12 plans were charitable or not.

13 Q Did the board make a strategic decision in 2001 to try to
14 avoid disputes or litigation about the charitable or not
15 charitable nature of Premera by offering to transfer the
16 stock in New Premera to one or more foundations that would
17 carry out a charitable purpose?

18 A No. The board never assumed that Premera was a charitable
19 organization. It is a tax-paying, nonprofit corporation,
20 not a charitable organization. It has never been the
21 assumption of the board that it was.

22 Q I hear you.

23 Did the board, nevertheless, make a decision to try to
24 avoid a dispute about whether the company was charitable by
25 structuring the conversion transaction so as to have the

1 stock of New Premera transferred to one or more foundations
2 that would carry out a charitable purpose?

3 A No. The discussion around the foundation shareholders had
4 nothing to do with any discussion about whether or not
5 Premera was a charitable corporation. The - as a director,
6 I recall asking the question about why the value of Premera
7 would need to go to a foundation. We were told as board
8 members that this is how several Blue plans had been
9 constructed.

10 And as a board member, one of your duties is to say,
11 "Who am I serving?" If you are a public company board of
12 directors, you have oversight by the market in addition to
13 serving a broad constituency. That I think is less clear in
14 a nonprofit context - or a mutual company like Washington
15 Mutual was before it converted to be a public company.

16 So who owns Premera is something that we did think
17 about. And as the transaction structure of several other
18 Blues was shared with us and the notion of a foundation
19 being created where 100 percent of the value of the - 100
20 percent of the stock was transferred to that foundation
21 seemed to me to be a very - a very elegant solution.

22 The accumulated capital of Premera over time since it
23 was founded in the '40s here and in the '50s in Alaska comes
24 from the retained earnings and the operating margins of
25 many, many thousands of people in those states, residents in

1 those states over the years. So the thought that one could
2 transfer that stock - the value of which is determined by
3 the market would go into the foundation seemed to me to be a
4 very elegant solution. Premera would be able then to have
5 access to the public markets to raise incremental capital to
6 support its future growth and there would be no question
7 that the citizens of Washington and Alaska who had supported
8 this company over the years would benefit through these
9 foundations.

10 Q Was it the board's intention to transfer 100 percent of the
11 value of the company to the foundation or foundations?

12 A As I said to begin with, I questioned as a director whether
13 we needed to transfer any to begin with to try and
14 understand this question of what was appropriate and right.
15 So there certainly was a discussion about what should be
16 transferred.

17 And we began a process of educating ourselves on the
18 conversions that had happened around the country and
19 concluded that transfer of 100 percent of the stock at
20 conversion would be an appropriate thing to do. But we did
21 not start out there. We started out as, perhaps, some of
22 this audience is beginning to learn, how these transactions
23 are structured. And we went through a very lengthy process
24 of educating ourselves on that before we reached that
25 conclusion.

1 Q Was it the board's intention that the stock transfer would
2 represent 100 percent of the value of the company as of the
3 date of conversion?

4 A No. It was the board's intention that 100 percent of the
5 stock at the time the company converted would go to the
6 foundations. The value that we realized by the foundations
7 will be set by the market. As that stock is sold, the
8 assets are monetized and the cash goes to fund the
9 charitable organizations.

10 Q To your knowledge, has Premera's management or board ever
11 stated internally or externally that it intended to transfer
12 100 percent of the value of the company as represented by
13 the stock to the foundations?

14 A My understanding is we have - our intention all along has
15 been to transfer 100 percent of the stock to the foundation,
16 the value of which will be determined by the market. I'm
17 not familiar with anything that might have been said over
18 the course of this proceeding, but that is my understanding.

19 Q You testified about the diligence that the board conducted
20 around this decision. In connection with its diligence, did
21 the board retain consultants to advise it regarding the
22 issues that are presented in this hearing, such as access to
23 health insurance, impact on premiums, impact on providers,
24 service to customers?

25 A We had many discussions around that. The consultants

1 primarily that the board had discussions with were Goldman
2 Sachs. They were compensation consultants and they were
3 legal consultants, Saul and Cromwell, as I mentioned before.

4 Q So should the Commissioner take it that your answer to my
5 question is no, the board did not retain consultants to
6 advise it on what I will call health impacts?

7 A I don't recall specific consultants that we had that were
8 retained to address health impacts. We had many discussions
9 about what might the impact be on providers, what might the
10 impact be on subscribers. As a board, we want to ensure
11 ourselves - assure ourselves that the company is viably
12 going forward.

13 But I don't recall specifically that we had consultants
14 opining on those issues. It was more our own discussion.
15 And, of course, we have a number of board members that are
16 from the provider community. In addition, we - we had
17 sometimes conversations ourselves with individuals in the
18 provider community to gain some sense that this would not be
19 a problem, but I do not recall specific consultants brought
20 in to talk to us about that.

21 Q And are you implying that the sense the board received from
22 its conversations with what you called the provider
23 community, is that provider community was positive towards
24 the idea?

25 A I think it is fair to say - and this is coming largely from

1 the medical community on our board - that the provider
2 community is uncertain about what the conclusions are going
3 to be. And Premera must have solid relationships with its
4 provider community to be a sound business.

5 And I think what is abundantly clear is that over the
6 last few years Premera has enhanced its relationship with
7 the provider community. The company does surveys on a
8 regular basis with providers to determine how the company is
9 being viewed by them. And those surveys have been improving
10 over time. And we believe the relationship with our
11 providers overall is as strong as it has been.

12 So, you know, everybody is going into a new transaction.
13 Something they are uncertain about. There is a certain
14 amount of apprehension and I think that that's
15 understandable.

16 Q Ms. Jewell, you testified about the experience of the
17 University of Washington Medical Center, Harborview Medical
18 center, as large providers of charity or uncompensated
19 care --

20 A Mm-hmm.

21 Q -- in the region.

22 Do you know for 2003, what was the total amount of
23 uncompensated care provided by those two hospitals?

24 A I don't have that figure with me.

25 Q Do you think it might exceed 25 million?

1 A Yes.

2 Q Do you think it might exceed 100 million?

3 A It might.

4 Q Thank you.

5 MR. MADDEN: I have no further questions.

6 THE WITNESS: Okay.

7 JUDGE FINKLE: Other Intervenors?

8 MS. McCULLOUGH: No, thank you.

9 JUDGE FINKLE: Redirect?

10 MR. KELLY: No redirect.

11 JUDGE FINKLE: Anything that came up that you would
12 like to follow up on?

13 MS. DeLEON: No.

14 JUDGE FINKLE: Any questions?

15 COMMISSIONER KREIDLER: No.

16 JUDGE FINKLE: Thank you. Please step down.

17 It is about a quarter to twelve. Do you want to spend
18 15 minutes with the next witness or start back 15 minutes
19 earlier than scheduled?

20 MR. KELLY: I think we would like to start 15
21 minutes early this afternoon, if we could.

22 JUDGE FINKLE: So break now?

23 MR. KELLY: Break now.

24 JUDGE FINKLE: We will be back now at 1:15.

25

1

2

(Lunch recess.)

3

4

JUDGE FINKLE: Okay. Let's resume. Premera should
call its next witness.

5

6

MR. KELLY: Gubby Barlow please come forward and be
sworn.

7

8

9

GUBBY BARLOW, having been first duly
sworn by the Judge,
testified as follows:

10

11

12

13

JUDGE FINKLE: Please sit down.

14

15

DIRECT EXAMINATION

16

17

BY MR. KELLY:

18

Q Would you state your name, please?

19

A Gubby Barlow. My given name is Hobert Randall Britain
Barlow.

20

21

Q Could you state your employer and position?

22

A I'm employed by Premera and Premera Blue Cross where I am
President and Chief Executive Officer.

23

24

Q Could you tell us your educational background?

25

A I have a bachelor's of commerce degree as well as bachelor's

1 of business administration from the University of Cape Town.

2 I have also completed two executive management courses at
3 UCLA.

4 Q Could you give us an overview of your professional career?

5 A I started my career in 1973 in public accounting with
6 Deloitte in a Cape Town office in South Africa and spent 18
7 years with that firm including periods between 1977 and 1979
8 in the St. Louis office of Deloitte. Went back to Cape Town
9 where I became a partner in 1982 in the audit division.
10 Returned to the United States in 1987 where I joined the Los
11 Angeles office of Deloitte, became a partner at Deloitte in
12 1989.

13 Q Okay. Now, when you were working for Deloitte in South
14 Africa, were you the equivalent of - did you have an
15 equivalent of a CPA license?

16 A That's correct. I became a chartered accountant in South
17 Africa, which is the South African equivalent of a CPA.

18 Q And when you came over to United States I think the second
19 time in the mid to late '80s, did you take the CPA exam,
20 too?

21 A Yes. I returned to the states in November of '87 and became
22 a CPA in May of 1988.

23 Q Now, when you left Deloitte, did you go into private
24 industry, and if so, where did you work?

25 A Yes. I left Deloitte to join HealthNet in California in

1 April of 1991, worked at HealthNet for about four-and-a-half
2 years until the middle of July 1995. I started at HealthNet
3 as Vice-president of Finance. I progressed up and when I
4 left I was a Senior Vice-president of Finance and Customer
5 Service as well as the Chief Financial Officer of the
6 California operation of HealthNet.

7 Q And what was your next position when you left HealthNet?

8 A I left HealthNet to join AHI Healthcare Systems,
9 Incorporated, which is a physician practice management
10 company, in July 1995. I served as Senior Vice-president
11 and Chief Financial Officer until the company was sold,
12 which was in March of 1997.

13 Q And at the time - with that sale, did you then come to
14 Premera?

15 A That is correct. I joined Premera in March 31, 1997.

16 Q You started as Chief Financial Officer and then became what?

17 A Yes. I was appointed Executive Vice-president and Chief
18 Financial Officer. Shortly thereafter, I was appointed as
19 Chief Operating Officer and served as Chief Operating
20 Officer and became President in December of 1999. I was
21 appointed Chief Executive Officer and President in July of
22 2000.

23 Q Okay. Are you a member of any professional organizations?

24 A I'm a member of the California Society of Certified Public
25 Accountants as well as the American Institute of Certified

1 Public Accountants.

2 Q Do you currently sit on the board of any local companies or
3 other organizations other than Premera or its subsidiaries?

4 A Yes. I'm on the board of advisors to the dean of the school
5 of nursing at Seattle University. I'm also on the board of
6 the Washington Healthcare Forum.

7 Q Can you tell us what the Washington Healthcare Forum is for
8 our record?

9 A The Washington Healthcare Forum is a coalition of
10 physicians, hospitals, purchasers as well as health plans
11 that have come together to work on improving the efficiency
12 and effectiveness of the health system in Washington.

13 Q Are you on any other boards?

14 A As a Blue CEO, I also automatically become a director of the
15 Blue Cross/Blue Shield Association. I'm also on the board
16 of the National Institute of Healthcare Management, LLC, and
17 its affiliated foundation.

18 Q Okay. And can you tell us what the National Institute of
19 Healthcare Management Foundation is?

20 A The foundation is a nonprofit, nonpartisan organization that
21 is focused on working on the efficiency, effectiveness and
22 quality of the healthcare system in the United States.

23 Q Okay. Let me turn now to your prefiled testimony. Both
24 your prefiled direct and prefiled responses have been served
25 and filed. And as I asked the last witness and we will

1 probably ask every witness, do you adopt that testimony?

2 A Yes, I do.

3 Q Okay.

4 MR. KELLY: And I would ask that the prefiled direct
5 marked as hearing Exhibit P-4 and the prefiled responses
6 marked as hearing Exhibit P-7 be admitted?

7 MR. HAMJE: No objection.

8 MR. MADDEN: No objection.

9 JUDGE FINKLE: Admitted.

10 Q (BY MR. KELLY) I would like to have you us give us a very
11 brief thumbnail sketch of Premera.

12 A Premera serves about one-and-a-half million members. We
13 have revenues in 2003 of approximately 2.8 billion dollars.
14 We employ approximately 3,200 people, most of them employed
15 in Washington State.

16 Q Okay. Now, while you were testifying behind you came on the
17 screen an overview, which I should explain is an
18 illustrative exhibit from Exhibit P-90. And does that help
19 illustrate the testimony that you have just given?

20 A Yes, it does. It shows the breakdown of our members - the
21 one-and-a-half million members. Most of them - as you see,
22 1.3 million are in Washington State.

23 Q Okay.

24 MR. KELLY: I think that's all we need for that.

25 Q (BY MR. KELLY) In your prefiled direct testimony you gave

1 an overview of Premera organizational structure, did you
2 not?

3 A Yes, I did. And I would be happy to answer the
4 Commissioner's question that he may have on that
5 organizational structure.

6 Q Okay. Now, you testified in your prefiled testimony that
7 Premera's corporate mission statement is to, quote, "Provide
8 peace of mind to our members about their healthcare
9 coverage," end quote.

10 How did Premera develop that mission statement?

11 A Well, back in 1998 we were trying to figure out why do
12 people come to us as customers. And we believed that our
13 policyholders are buying policies to provide peace of mind
14 to our members about their healthcare coverage. In other
15 words, that the health plan would be around to provide
16 service - healthcare service to members when they need it.

17 Q Okay. So what does Premera have to do as a business in
18 order to meet that corporate mission?

19 A Well, there are a few elements to peace of mind, in my view.
20 The first is that we should provide broad networks of
21 physicians and hospitals that our members can access. The
22 second is that we should provide flexible products that are
23 helpful to our members in making the selection of what fits
24 them. The third is we must obviously provide excellent
25 service. And the fourth is financial stability. Our

1 members must know that we are financially stable and will be
2 around when they need us.

3 Q And that fourth element is tied to the adequacy of capital;
4 is that correct?

5 A It certainly is.

6 Q Do you then recognize - or does Premera recognize that the
7 health insurance is a consumer-driven business?

8 A Yes, it certainly is a consumer-driven business. And our
9 members are looking for a number of things from us, but it
10 is very much focused on what they need.

11 Q Now, you also testified in your prefiled testimony that
12 Premera's corporate vision is, quote, "We are the health
13 plan of choice and the standard of excellence in our
14 region," end quote.

15 How is Premera working in order to help achieve that
16 vision?

17 A We seek to become the health plan of choice, in other words,
18 the plan that people think of first, through operational
19 excellence, which means that we - we strive to deliver
20 excellent service that is hassle-free, market responsive.

21 Q Okay. In your prefiled testimony, you also talk about
22 Premera's corporate values, which you indicated in your
23 testimony include excellence, customer care, integrity and
24 leadership.

25 My question to you is this: Can you give an example of

1 a project that Premera undertook that incorporates all of
2 those values?

3 A It - the most important project that we have undertaken in
4 recent time is the Dimensions product or as previously
5 testified, what was originally the Business and Systems
6 Transformation project, which resulted in the Dimensions
7 project - product. And that project encompassed all of the
8 values and one more which is not mentioned in the prefiled,
9 and that is teamwork.

10 Q Okay. And part of the team began working on that project in
11 when? 2000?

12 A We commenced the - the board authorized us to take on the
13 project in around about August of 2000. We worked on it
14 diligently over the next couple of years and formally
15 launched the product in January of 2003.

16 Q What led to the development of Dimensions?

17 A You know, as we looked around, there were customer concerns
18 about our industry - products offered by our industry in
19 that they were inflexible, confusing, hard to understand and
20 costly to administer, so we wanted to find a solution to
21 that complexity.

22 Q How do members benefit from being able to utilize
23 Dimensions?

24 A Well, the Dimensions product - product, we have made it much
25 simpler for our members and provided them with more choice

1 by decoupling the benefits offered from the network. In the
2 old world, HMO's were pretty restricted networks with rich
3 benefits. PPOs were much broader with less rich offerings.
4 We wanted members to be able to choose the kind of benefits
5 they wanted with the size of the network that they would
6 prefer.

7 Q So there is some utilization of e-Enablement. Could you
8 explain that?

9 A That is a very important part of what we were striving to
10 do. With e-Commerce having emerged in the late 1990s and
11 certainly early 2000, we wanted this product to be easily
12 accessible through electronic means to our members as well
13 as - I should say to our providers.

14 Q That was going to be my next question. How do providers
15 benefits from Dimensions?

16 A Well, we - one of the complaints that providers have is that
17 there are many different payment rules and - that make it
18 very - and different payment methods - administrative rules
19 and payment methods that apply to the different products,
20 the HMO and PPO products.

21 We wanted to make it simple for them by decoupling, once
22 again, how they are paid from the members contract, so that
23 they have one set of rules and payment models to work with.
24 And, once again, as I was saying, we e-Enabled it so that
25 they can interact with us electronically.

1 Q Now, what has been the reaction to Dimensions?

2 A I believe that Dimensions has been a huge success in the
3 short time that we have had this product. It is being
4 well-accepted by our customers, by our members, by providers
5 as well, in spite of the fact that we have more than 550,000
6 of our members on that product today.

7 Q Now, I think you indicated that it was a very expensive
8 investment to create - develop and create Dimensions. Can
9 you explain more about the cost?

10 A It has cost us about 125 million dollars to date and
11 obviously it is a very significant investment for a company
12 of our size representing a very large slice of our capital
13 reserves.

14 Q And is that the end of the story now that you have got
15 Dimensions or what is the reality?

16 A If only that were so. We have to continue to invest in
17 Dimensions. The next iterations of the product and the
18 market are right upon us.

19 Q Okay. And those, I take it, will cost money as well?

20 A Yes, they will.

21 Q Let's turn specifically to Premera's conversion. In your
22 view, will Premera's subscribers and the insurance buying
23 public benefit from conversion?

24 A Yes, they will.

25 Q Okay. And how will they be helped?

1 A Talking specifically about subscribers?

2 Q Yes, that's correct.

3 A Our subscribers will be helped in that we will have
4 additional capital to invest which will immediately
5 strengthen our reserves so that they have additional peace
6 of mind about their healthcare coverage.

7 It will provide us with the capital to grow our
8 membership. And then, finally, it will provide us with
9 additional capital to continue to invest in products and
10 services that the market desires.

11 Q Okay. Now, I have asked you to take a look at an
12 illustrative slide that we have, it is Exhibit P-90, Page
13 Number 3. And if you could - I think you should have a copy
14 of it in your folder and hopefully everyone has a copy that
15 can see it. It is entitled, "Why is Premera Seeking
16 Capital?"

17 Does this help illustrate your testimony here?

18 A Yes, it does. Those are the three points I made.

19 Q Okay. Let's talk - before we get to that, let me ask you
20 this: In your view, is this Premera conversion a
21 win-win-win for people, and if so, how would you explain it?

22 A From the offset, I have said that I believe that the
23 conversion is three wins. The first win is for our members
24 in that it provides us with the addition capital to serve
25 them better. It is a win for the State of Washington in

1 that it provides a capital to a local company to continue to
2 grow, bringing attractive products, but importantly it
3 supports the employment and the tax base.

4 And, thirdly, it is a win for the people of Washington
5 and of Alaska through the creation of a very significant
6 health plan to support unmet health needs in the two states.

7 Q Okay. Let's go back to the first bullet point on Exhibit
8 P-90, strengthening capital reserves. Let me ask you, as a
9 nonprofit, what is your only real source of capital?

10 A The major source of capital for us is our operating income,
11 which represents in 2003 about 1.7 percent of our revenue.
12 In addition to that, we have investment income as well as we
13 pay taxes.

14 Q But the primary source would be whatever profits you
15 would --

16 A That is correct.

17 Q Okay. Now, let's go to something that has been talked about
18 a little bit so far, capital reserves.

19 How are capital reserves measured in a nutshell, if you
20 can?

21 A The National Association of Insurance Commissioners
22 established a very complex formula called risk-based capital
23 that sets the benchmark for capital adequacy for health
24 plans. At the end of 2003, Premera's risk-based capital was
25 433 percent. To put that into perspective, the average at

1 the end of 2003 for the Blue plans was 712 percent.

2 Q Okay. So average was 712 and Premera was only 433?

3 A That's correct.

4 Q I think Mr. Coopersmith mentioned that there had been an
5 increase from 2002 - I think it was 406 percent to 433, but
6 generally what is your understanding as to how the average
7 was in 2002 and whether it increased or not in 2003?

8 A Well, Mr. Coopersmith was right. Our risk-based capital did
9 increase slightly in the two years. The Blue Cross
10 associations average - I can't remember what it was. I
11 believe it was around about 650, but it, too, increased to
12 this 712 and it increased more than ours did.

13 Q But relatively speaking, was there any improvement for you?

14 A No, there was not, not relative to the Association's - the
15 Association's average.

16 Q Okay.

17 A And, as we mentioned, as is - ours is the fourth lowest in
18 the - within the Blues and we would like to increase it to
19 around about 600 percent through the acquisition of outside
20 capital.

21 Q Okay. Why is Premera setting an objective of 600 percent
22 for its --

23 A Well, the minimum before we go on to an early warning list
24 is 375 within the Blue Cross/Blue Shield Association. And
25 we believe that it is prudent to increase that - our buffer

1 between that and the fourth, so we are at 433. There is not
2 much of a buffer between 433 and 375 and so we want to
3 increase it to deal with all of the economic uncertainties
4 that we face.

5 Q Okay. And is - are there other things that you would then
6 be able to do with a higher RBC?

7 A Clearly the objective again with a higher RBC, we would be
8 able to pursue these other items that are up on the board.
9 We will be able to continue to grow our membership and to
10 invest in infrastructure and product.

11 Q Okay. That brings us to the second bullet point, improved
12 ability to support membership and future membership.

13 Now, has Premera's membership grown?

14 A Our membership has grown by about 38 percent between the end
15 of 1999, four years later, to the end of 2003.

16 Q Now, in your view, why is membership growth good for current
17 members and for the insurance buying public in general?

18 A Well, starting with the insurance buying public, obviously
19 they are buying insurance. Say if they buy ours, we are
20 meeting the market need. But it is also good for our
21 existing members in that increasing the membership through
22 the acquisition of new members means that we have more
23 members to spread our technology investments and
24 infrastructure investments over a broader base, which
25 benefits all the members.

1 Q But why do you have to have capital reserves in order to
2 grow membership? Don't the additional premiums that you get
3 with each new member provide you with the money that you
4 need?

5 A Well, members will pay for themselves over time. That's our
6 expectation. They will be profitable over time, but it
7 takes a long time for each member to build up the risk-based
8 capital that relates to them specifically. As you sell to
9 them, though, you need that risk-based capital on day one
10 when they come through the door and are enrolled as a
11 member.

12 Q How does the conversion help Premera deal with this
13 situation of the need for capital with growth that profits
14 alone can't get you?

15 A Well, in two ways. First, through the conversion and an IPO
16 we will raise additional capital for the company. We hope
17 that will be in the range of 100 to 150 million
18 dollars. But further than that, as we look out to the
19 future, it gives us the flexibility to issue more stock and
20 raise more capital through that process in the future as the
21 needs of the company increase.

22 Q Okay. Let's turn to the third bullet point. How, in your
23 view, will the proposed conversion help Premera deliver,
24 improve new products, technology and services to its
25 subscribers?

1 A This is a very capital-intensive business. It takes money
2 to develop all of these products and we will continue to do
3 that as was mentioned. We finished our first phase of our
4 Dimensions product, but already we have new demands that
5 have come on, not to the least of which is the consumer
6 directed health plans, which is a term of art that is
7 gaining traction in the health insurance industry.

8 So that is one area that we would apply, is developing
9 the new - meeting the new needs that are developing in the
10 marketplace from our member's perspective. But I should
11 also say that there are needs to help support our providers
12 and therefore our members by extension.

13 One of the visions that we have is that we would be far
14 better integrated with the providers electronically so that
15 you can imagine there will be a time when a member walks
16 into the office - a patient walk into the physician's office
17 and before they leave, the bill will be submitted by the
18 physician's office to Premera, paid on-line, submitted back
19 and the patient will know exactly what their share of the
20 bill is. The provider will be paid and that will be the end
21 of the transaction. There will be none of this to and fro.

22 That is going to take a lot of capital. That is just
23 one of the examples of the needs that we see in the future.

24 Q Okay. And do you see a benefit to the public in general
25 from the conversion?

1 A Well, as I said earlier, there is a number of benefits.
2 First of all, we are a viable company that is providing
3 innovative products to the marketplace, so that would be the
4 first.

5 Second would be that we support the employment base in
6 Washington. The third, the tax base, and then fourthly, the
7 creation of this foundation --

8 Q Okay.

9 A -- which is going to raise a significant amount of money, by
10 the state's consultants reports, estimates in the range of
11 500 million to 700 million for the foundations alone.

12 Q And how does that compare on a per capita basis to other
13 foundations that are created in other conversions?

14 A It is my understanding that this foundation on a per capita
15 basis, taking into account the populations of Washington and
16 Alaska, would be amongst the largest ever created, if not
17 the largest on a per capita basis in - of all the Blue
18 conversions that have occurred.

19 Q Will the conversion affect Premera's corporate vision
20 mission or values that you talked about earlier this
21 afternoon?

22 A Absolutely not. The whole purpose for pursuing this
23 conversion is to enable us to pursue our mission better.

24 Q What about the possibility of the takeover effort by another
25 insurance company once Premera converts?

1 A There is always that possibility, whether you are a
2 for-profit or not-for-profit, just different rules apply.
3 But we have in our filings taken advantage of the law of
4 anti-takeover laws available to us and the Washington law
5 except to the extent requested to not take advantage by the
6 state's own consultants.

7 Further, there is also protection in the future in that
8 the Insurance Commissioner would be required under the
9 Holding Company Act to approve any acquisition of the
10 company should it be recommended by the board of directors.

11 And then thirdly, the foundations that will be created
12 will have a free vote in terms of any takeover of the
13 company.

14 Q Now, I would like to talk a little bit about Eastern
15 Washington. Some witnesses have expressed concern about
16 Premera's market position in Eastern Washington. Could you
17 comment on those concerns?

18 A Well, we do have a strong position in Eastern Washington.
19 It is a very important market to us and we continue, as
20 always - continue to nurture it because it is important to
21 us. We have no intention of pulling out of Eastern
22 Washington, which has been one of the allegations that I
23 have seen.

24 Our statewide network is a very important part of the
25 value proposition that our company brings to the

1 marketplace. And the statewide network is one of the assets
2 of the company that we intend to maintain.

3 Q Okay. And do others who will be testifying here also have
4 further information about our position in Eastern
5 Washington?

6 A There is testimony that will be heard from our economist
7 about our market position in Eastern Washington.

8 Q Okay. Let me turn to another area. The Intervenor's
9 testimony, and perhaps the opening argument today - sort of
10 opening statement - suggests that Premera is a charitable
11 organization operating for the benefit of the public. Is
12 that an accurate characterization, in your mind, of
13 Premera's business?

14 A We are not a charity. We operate a commercial enterprise
15 whereby we provide health insurance services to our members
16 in exchange for the payment of the premium in cash.

17 Q And people are paying for the services that you are
18 providing, as far as you know?

19 A They do.

20 Q Okay.

21 A They pay for the service they receive in cash.

22 Q Does Premera provide healthcare coverage or services on a
23 charitable basis to any individual or group?

24 A We do not provide charitable health coverage to any group
25 today --

1 Q Now, do you have --

2 A -- or never have, to my knowledge.

3 Q Now, does Premera have a charitable giving program?

4 A Yes, we do, like many for-profit and not-for-profit
5 responsible organizations within society, we also have a
6 charitable giving program.

7 Q And that charitable giving program doesn't make Premera a
8 charity, does it?

9 A It certainly does not. If it did, it would make a lot of
10 for-profit companies that are well-known in our society
11 charities, which we know they are not.

12 Q Okay. Let me turn to the Blue Cross/Blue Shield license
13 requirement issue. Now, I think Premera and Premera Blue
14 Cross are licensees of the Blue Association, as it is
15 called.

16 Can you explain what is involved in being a Blue
17 Association licensee?

18 A As a licensee, it gives us the right in our service area to
19 use the Blue Cross/Blue Shield marks where we were licensed
20 in exchange - and that is a very valuable asset to the
21 organization.

22 In exchange for that, we do have to live under certain
23 rules and regulations of - around our capital and brand
24 protection that are being - that have been adopted by the
25 Association because they deem them important to protect the

1 brand.

2 Q Does the Premera conversion as it is currently structured
3 under this Amended Form A meet the requirements that the
4 Blue Association has for those plans that want to both
5 convert and also to maintain their Blue license?

6 A Yes. Our filing has been reviewed by the staff of the
7 Association and we are in discussion on certain items, but I
8 believe that in - the greater part it does meet the
9 requirements of the Association.

10 Q Would you describe those as minor provisions that are still
11 under discussion?

12 A They are minor provisions.

13 Q There are some that are more major. I'm going to get to
14 those in a minute.

15 And those are the provisions that the OIC consultants
16 would like to see in the Amended Form A that are at odds, as
17 I understand it; is that correct?

18 A Yes. The - the state's consultants have requested us to
19 adopt what they - what they term "duplicate foundation
20 rights." Those rights include for each of the foundations,
21 the one in Washington and the one that is to be established
22 in the Alaska, those duplicate rights include a three to
23 five percent vote.

24 And I don't want to get too technical, but they are in
25 my prefiled testimony. Three to five percent vote on five

1 percent of the holding, the appointment of a member of the
2 board of directors from each foundation, so two board
3 members, and stand-alone divestiture schedules.

4 Q So that Alaska would have to sell down at one rate and
5 Washington at another rate?

6 A They would have to sell down - that's right - in a combined
7 divestiture schedule that is agreed to by the Association.

8 Q Now, what was the reaction of the Blue Association to those
9 three provisions?

10 A We did talk to the staff - at least members of our
11 management spoke to the staff of the Association before we
12 filed our Amended Form A in February. And they - the staff
13 of the Association, who are familiar with this topic,
14 advised us that - where those requirements would be in
15 violation of the rules of the Association. So we went ahead
16 and filed the - in compliance with the Blue rules.

17 Q Okay.

18 A And so our current filing is in compliance.

19 Q Okay. Now, does this mean that the Blue Association is
20 somehow trying to dictate terms to the Washington
21 Commissioner about the conversion?

22 A Absolutely not. The Blue Association really has no
23 philosophy as to whether a company should be for-profit or
24 not-for-profit. What it does say is that if a company is
25 going to be for-profit, it must comply with certain rules

1 that are being established for other conversions that it
2 deemed it should adopted in order to protect the brand.

3 Q And - well, I think you said earlier the Blue license is a
4 significant asset for Premera; is that correct?

5 A It certainly is.

6 Q And would Premera be able to pursue conversion if it was not
7 consistent with the requirements of the - the requirements
8 of the conversion were not consistent with the Blue license
9 requirements?

10 A Well, we simply could not pursue conversion. If we were to
11 lose our license, there would be no point in trying to take
12 this company public. There would be no investors. We would
13 lose tremendous value through the loss of our license.

14 Q Now, you said that staff had contacted the Blue Association
15 before the Amended Form A filing. What have you done after
16 that to try and persuade the Association to reconsider its
17 position?

18 A Right. Immediately after the filing, we requested a meeting
19 with the Plan Performance Financial Standards Committee,
20 PPFSC, which is the committee of the board of the Blue
21 Cross/Blue Shield which has responsibility for reviewing
22 these kinds of transactions and making recommendations to
23 the full board of the Association. But I have never in my
24 experience have had any instance where their recommendations
25 were not adopted for these transactions.

1 Q Did you actually develop a petition to present to that
2 PPFSC?

3 A Yes, we did. We sent them a position paper explaining the -
4 the three items that I previously outlined and advocating, I
5 should say, that before the adoption - in other words, them
6 granting a license exemption allowing us to adopt these
7 three provisions which have been sought by the state's
8 consultants.

9 Q So you were acting in support of those --

10 A Yes, we did.

11 Q Okay.

12 A My staff - our chief legal officer and our general counsel and
13 I then went back - back east to meet with the PPFSC. I
14 believe it was on March 18th, to appear in person to plead
15 our case. They received - they respectfully listened to our
16 case and at the end of the meeting they sent us a letter
17 giving us their decision.

18 Q Okay. Let me first direct your attention and the
19 Commissioner to Premera Hearing Exhibit No. P-4. And I
20 think you have a copy of it, Mr. Barlow.

21 MR. KELLY: Is it P-5?

22 Q (BY MR. KELLY) okay. P-5.

23 A Yes. P-5 includes the position paper that I had spoken of
24 earlier.

25 Q Okay. And what happened as a result of the meeting that you

1 had using this position paper to try and make these changes?

2 A As I said, we met with them. At the end of our presentation
3 we left and they communicated - we heard informally what
4 their position was, but they did write us a letter which is
5 reflected, I believe, in P-6.

6 We received a letter from Roger Wilson, who is general
7 counsel of the Association, which outlines their position,
8 which in essence - if I could summarize it without going
9 through all the detail - which in essence, agreed that they
10 would recommend to the board of the Association to allow two
11 directors to be appointed, one from Washington, one from
12 Alaska. They did not agree to grant the five percent voting
13 block - the two free voting blocks. They said there should
14 only be one. And they also said that there should be one
15 divestiture schedule.

16 Q Okay. So basically of the three, you were at least able to
17 get one?

18 A We were successful on one.

19 MR. KELLY: I would like to move for the admission
20 of P-5 and P-6.

21 MR. HAMJE: No objection.

22 MR. MADDEN: No objection.

23 JUDGE FINKLE: Admitted.

24 Q (BY MR. KELLY) Mr. Barlow, do you think you did your very
25 best to get the Blue Association to agree to all three of

1 the conditions?

2 A I believe we made a compelling case. They - and we did our
3 best.

4 Q Okay. Let me turn to a little discussion about the Amended
5 Form A before we wrap up this introductory question and
6 answer.

7 Now, in late December through sometime through January
8 of 2004, the Commissioner had previously authorized and
9 there were discussions between Premera and the OIC staff and
10 its consultants, which the Intervenors were present as
11 observers. After those meetings, Premera filed its amended
12 Form A in February of 2004. My question is what generally
13 was discussed at those meetings?

14 A I believe - well, what was discussed was the items such as
15 the - the duplicate foundation rights, but also there were
16 discussions around assurances regarding the - our market
17 conduct in Eastern Washington, assurances around executive
18 compensation and around stock plans --

19 Q Okay.

20 A -- amongst other discussion.

21 Q And as a result of those meetings, was progress made, and if
22 so, how would you describe it?

23 A I believe an enormous amount of progress was made and we
24 narrowed the issues to the few that are remaining in the
25 reports. And we made our filing to take account of the

1 progress that was made in - in those discussions in - in
2 February.

3 Q Do you think that making further changes would be harmful,
4 and if so, why do you think that?

5 A I do. I believe that the restrictions that are being placed
6 on us are already very conservative. I'm concerned that we
7 are being asked to restrict our practices in a way that
8 doesn't apply to any competitor in the marketplace therefore
9 tilting the playing field, which will not be of advantage -
10 in fact, will be harmful, I believe anyway, to - should -
11 should we adopt those restrictions to our members and the
12 insurance buying public in that one competitor will be
13 weakened.

14 Q Okay. One final area. Several witnesses have expressed a
15 notion that a nonprofit health plan is more attuned to the
16 interest of the insurance buying public than a for-profit
17 corporation. In your view, is that correct?

18 A I don't believe that at all. I believe that for-profit and
19 not-for-profit companies compete for a consumer-driven
20 business. If you are not attuned to the needs of those
21 consumers, you will not be successful and will lose
22 membership.

23 Q Are the business incentives and comparatives for for-profit
24 and nonprofit the same?

25 A I believe they are identical, satisfying a customer.

1 Q Well, what then - I'm sorry?

2 A Satisfying the customer.

3 Q What then, just to wrap this up, if anything, will change,
4 in your view, with the conversion?

5 A The major change is that conversion will give us the capital
6 to serve our members currently and future members than we
7 could otherwise.

8 Q You will be able to expand, I take it?

9 A Correct. We will be able to expand to new members. And in
10 effect, it will help to level the playing field against far
11 better capitalized competitors than we are.

12 Q Very good.

13 MR. KELLY: That's all that I have on direct. I
14 will turn the witness over to the other attorneys. Thank
15 you.

16 MR. HAMJE: May I proceed?

17 JUDGE FINKLE: Yes, please.

18

19 CROSS-EXAMINATION

20

21 BY MR. HAMJE:

22 Q Mr. Barlow, my name is John Hamje. I am a Special Assistant
23 Attorney General and I'm appearing on behalf of the OIC
24 staff today. What I would like to do first, if I could ask
25 counsel to help me, I would like to go ahead and share with

1 you a couple of staff's exhibits, Exhibits S-71 and S-96.

2 MR. KELLY: Okay. If I may approach, we have some
3 copies for the witness.

4 JUDGE FINKLE: That would be great. Thank you.

5 MR. KELLY: You are going to ask one at a time, I
6 hope.

7 MR. HAMJE: Yes, please. Thank you, sir.

8 A Which one did you want to address?

9 Q (BY MR. HAMJE) If we could take a look at S-71 first.

10 A (Complying.)

11 Q Have you located it, sir?

12 A Yes, sir.

13 Q Thank you.

14 I realize that the first page is the certification, but
15 the rest of it - do you recognize the rest of that document?

16 A Yes, it is a letter that I and Yori Milo wrote to
17 Commissioner Kreidler.

18 MR. KELLY: For the record, it is May 30, 2002.

19 MR. HAMJE: Thank you, Counsel.

20 Q (BY MR. HAMJE) And this letter was - if I understand it
21 correctly, was delivered to Commissioner Kreidler at the
22 time that - about the time that Premera had decided that
23 conversion was the proper course for it to take; is that
24 correct?

25 A About the time, yes. It was in the same month.

1 Q Same time frame?

2 A Yes.

3 MR. HAMJE: I would like to ask that S-71 be
4 admitted.

5 MR. KELLY: No objection.

6 MR. MADDEN: No objection.

7 JUDGE FINKLE: Admitted.

8 Q (BY MR. HAMJE) And then if I could refer you now,
9 Mr. Barlow, to S-96, please. Do you have that there?

10 MR. KELLY: I think that is the in the next --

11 MR. HAMJE: Is that in the next volume?

12 A S-96?

13 Q (BY MR. HAMJE) Yes. Have you located it yet?

14 A Yes, I have.

15 MR. HAMJE: I'm going to let the Commissioner and
16 Special Master take a second, too.

17 MS. SUREAU: Thank you.

18 JUDGE FINKLE: Thank you.

19 Q (BY MR. HAMJE) The first couple of pages constitute a
20 declaration; is that correct?

21 A It is a declaration of Robert B. Fallis.

22 Q And then the next document in it is a May 29, 2002, letter
23 to the Attorney General; is that correct?

24 A Yes. It is a letter from Mr. Johnson to Attorney General
25 Gregoire.

1 Q Do you recognize that letter?

2 A I believe I haven't seen this letter before. I may have. I
3 don't recall seeing it.

4 Q Going on to the next document, please. That's also a letter
5 dated May 30th, 2002, to the Attorney General; is that
6 correct.

7 A Yes, it is.

8 Q And it is signed by - the copy shows that you and Mr. Milo
9 signed it; is that right?

10 A That is correct.

11 Q And it is substantially the same as S-71; is that correct?

12 A I would have to compare them, but I - I - the topic would be
13 similar.

14 Q Okay.

15 MR. HAMJE: At this time, the Staff would offer
16 these certified copies of - these first two letters in
17 Exhibit No. S-96.

18 MR. KELLY: Your Honor, we have no problem with the
19 whole exhibit going in. I think they are all letters.

20 MR. HAMJE: Then I will just offer the whole thing.
21 It's just at this point in time the other letters are not
22 pertinent to the particular testimony that Mr. Barlow will
23 be giving today.

24 JUDGE FINKLE: Are you intending ultimately to offer
25 all of 96?

1 MR. HAMJE: Absolutely. Absolutely.

2 JUDGE FINKLE: Any objection from the Intervenors?

3 MR. MADDEN: No, Your Honor.

4 JUDGE FINKLE: Admitted.

5 MR. HAMJE: Thank you.

6 Q (BY MR. HAMJE) Now, Mr. Barlow, I wanted to ask you about
7 the reason that Premera determined to establish the
8 foundations and endow them with assets as part of this
9 proposed transaction. What is that reason?

10 A The reason that we pursued this course of awarding or
11 donating 100 percent of the initial stock of the corporation
12 to charitable foundations is that we looked around the
13 country to see how are conversions pursued by others.

14 Now, obviously in - every state is always different, but
15 what we saw made some sense in terms of stock needed to go
16 somewhere and making that stock available to unmet health
17 needs in the communities that we serve seemed like a
18 wonderful idea to our board and to me. And we structured
19 our conversion to do that, to give 100 percent of the
20 initial stock to those health foundations.

21 Q Did you anticipate that there might be a challenge to the
22 conversion based upon the question of whether Premera was -
23 is a charity or whether its assets are subject to charitable
24 limitations?

25 A I didn't think there would be a challenge to Premera in

1 terms of being a charity because we are not a charity.

2 Q But maybe I wasn't clear. A challenge to the conversion?

3 A I'm not clear what you mean. Could you rearticulate your
4 question?

5 Q Well, surely.

6 A You had a multiple question in there, so which one are you
7 asking? Did I think we had challenges and what kind of
8 challenges did you mean?

9 Q Did you anticipate - when you were preparing the proposal to
10 establish the foundations and endow them with these assets,
11 did you do so in anticipation that there might be a
12 challenge to the conversion for the reason that someone
13 would claim that Premera is a charity or its assets are
14 subject to charitable limitations?

15 A What - we did not - I did not expect that the donation of
16 our initial stock to charitable foundations would be
17 challenged, if that's your question. I did not expect that
18 to be challenged.

19 Q But my question was whether the conversion would be
20 challenged?

21 A Well, did I - if your question is did I believe that there
22 were people who would not favor conversion, yes, I did
23 expect there would be people who would not favor conversion.

24 Q What - and I don't want to belabor the point, but I want to
25 understand whether this particular use of - or the

1 establishment of the foundation and endowing them with
2 assets, whether that was a response on the part of Premera
3 to the potential for a challenge to the conversion on the
4 basis that someone might allege that its assets were subject
5 to charitable limitations? That's what I'm trying to get
6 at.

7 A Mr. Hamje, we were following what we thought that was a part
8 that other conversions had taken that made sense that had
9 been approved. We could have taken the position that we
10 would give that initial stock to somebody else. We could
11 have suggested, for example, perhaps it could go to our
12 members or to an employer group, which has happened, I
13 believe, in other conversions in different circumstances.

14 For us, it made sense - it seemed that the best course
15 for us was - the stock has to go somewhere - was to award it
16 to charitable foundations dedicated to health initiatives.

17 Q Did Premera believe that by taking this course that it would
18 improve the chances for the conversion to be approved?

19 A Well, this course relative to which? If you mean as opposed
20 to giving the stock, for example, to our members, I don't
21 think that really came into it. We thought that the
22 conversion would be approved on the merits that would meet
23 the standard, which as a layperson - I'm not a lawyer - as
24 broadly as I understand it, that it would not be harmful or
25 hazardous to the insurance buying public. That seemed to be

1 the nut from my interpretation. So that - my understanding
2 was the standard. Where the stock went wouldn't
3 particularly aid us meeting that standard. We felt that the
4 stock needed to go somewhere. A good place for it to go
5 would be to meet the unmet health needs, of which there are
6 many, in Washington and Alaska, as a way of giving back to
7 the communities where we have pursued our market.

8 Q Does Premera intend by this proposal to transfer the fair
9 market value of Premera's asset, the stock of New Premera,
10 to the foundation shareholders?

11 MR. KELLY: Objection. Compound question.

12 JUDGE FINKLE: Sustained. Please rephrase the
13 question.

14 Q (BY MR. HAMJE) Does Premera intend to transfer the fair
15 market value of Premera to the foundation shareholders?

16 A What we intend to do is to donate that initial stock of the
17 company to the foundations. Those shares will be sold over
18 time in the marketplace, in the stock market, which, I
19 believe, is the best arbiter of value that I can think of.

20 Q Let me ask you this way then, Mr. Barlow: Does Premera not
21 intend to transfer the fair market value of its asset to the
22 foundation shareholders?

23 A Our intention is very clear. It is to give the initial
24 shares of the company to those foundations. We believe that
25 fair market value of those shares will be realized over time

1 through sale in the stock market.

2 Q Premera is also seeking approval of the Attorney General of
3 Washington for the dissolution and distribution of all of
4 the assets of Premera; is that correct?

5 A I'm not clear. I believe that Attorney General would review
6 the transaction to ensure that the laws have been complied
7 with as they apply to the assets of Premera. Obviously one
8 of the investigations is around the nature of the assets.
9 And the Attorney General, if she should determine that there
10 are assets subject to charitable trust, then she would opine
11 on that.

12 We don't believe that there are assets subject to
13 charitable fund, but nevertheless, she needs to do her due
14 diligence around the form of the transaction and the nature
15 of the assets held by the organization. I believe that that
16 has been done.

17 Q You believe that the Attorney General has made her
18 determination?

19 A No. I believe that an investigation has occurred.

20 Q By the Attorney General's office?

21 A Well, by - not characterized - who the state's consultants
22 represent, they represent the Insurance Commissioner. But a
23 thorough investigation has occurred, as we know, of Premera.

24 Q Is it your understanding that the consultants have conducted
25 an investigation as to whether or not Premera or any of its

1 assets have charitable limitations?

2 A Actually, I think they have not. I think they worked on an
3 assumption, as is reflected in some of the deposition - I'm
4 sorry - in some of the prefiled testimony.

5 Q This - the transaction as it has been proposed involves the
6 acquisition of control of Premera Blue Cross and LifeWise
7 Health Plan of Washington, which are both healthcare service
8 contractors; is that correct?

9 A I believe that's correct.

10 Q It also involves the acquisition and control of LifeWise
11 Insurance company and LifeWise Health Plan of Arizona, which
12 are insurance companies; is that correct?

13 A I believe that's correct. I'm not sure which particular
14 part of the - they provide some of the service.

15 Q That's what I wanted to ask about, is do you have an
16 understanding of what the difference is between a healthcare
17 service contractor and an insurance company under
18 Washington's regulatory system?

19 A Do I personally? No. I know that we are registers of the
20 HCSC. I'm not clear on the technical differences.

21 MR. HAMJE: At this point, I am - I have made some
22 copies of an exhibit out of the Form A, Exhibit E-7. I
23 understand that we only have, I think, one copy of the Form
24 A here today. In fact, I would certainly - my understanding
25 was that this Form A was going to be made a Commissioner's

1 exhibit and I would like to go ahead at this point in time
2 and ask that it be admitted as the Commissioner Exhibit 1.

3 JUDGE FINKLE: The entire Form A, I'm assuming?

4 MR. HAMJE: When I say the Form A, I mean the
5 original Form A that was filed that's supplemented and the
6 then the revised Form A that was filed in - in February.

7 JUDGE FINKLE: Any objection?

8 MR. KELLY: This is just a suggestion, that I think
9 it ought to be admitted as two exhibits; the original Form A
10 with any corrections and additions that are there and then
11 the Amended Form A that was filed in February of 2004, but
12 otherwise no objection.

13 MR. HAMJE: I would have no objection to splitting
14 them up either. I think that it is in order and helps
15 clarify the record.

16 JUDGE FINKLE: Any objection?

17 MR. MADDEN: No.

18 JUDGE FINKLE: Commissioners Exhibit 1 and 2, the
19 original Form A and Amended Form A are admitted.

20 MR. HAMJE: Now, what I have done is since we have
21 only got one Form A, I have gone ahead and taken out of my
22 copy of the Form A Exhibit E-7. And I would like to go
23 ahead and share that with counsel and with the witness and
24 with the Commissioner and the Special Master, so we can go
25 ahead and maybe refer to it. It is not necessarily - it has

1 got some markings on it such as some names scrawled in the
2 corner and a couple of contract sheets with some writing on
3 them, but in the end they have nothing to do with the
4 substance.

5 MR. KELLY: No problem as long as it is clear. Is
6 this from Exhibit 1, the original Form A, or from the
7 Amended Form A.

8 MR. HAMJE: This is from Exhibit 1 - this is one
9 exhibit that was not changed. Now, let me make sure of
10 that.

11 MR. KELLY: Okay.

12 MR. HAMJE: Yes, that is correct. It does not
13 include Exhibits F through H that were part of exhibit - no,
14 it is only E-7. I'm sorry.

15 May I approach the witness?

16 JUDGE FINKLE: Yes.

17 THE WITNESS: Thanks.

18 MR. HAMJE: You're welcome. Thank you.

19 THE WITNESS: Do I need this?

20 MR. HAMJE: Probably not. I can move it.

21 THE WITNESS: No, that's okay.

22 MR. HAMJE: I have a number of questions about this
23 particular exhibit and at the appropriate time - there are a
24 number that I'm reserving until we get to a point of time
25 where we are at the end of my questioning and I think it

1 might be a time when we want to determine whether or not my
2 questions would lead us to issues that might - or answers
3 that might be lead to confidential proprietary information,
4 but I'm going to start with some questions that hopefully
5 will not elicit that type of information.

6 Q (BY MR. HAMJE) Mr. Barlow, if you would take a look at Page
7 23.

8 A (Complying.)

9 Q If you will look at the second complete paragraph on that
10 page, it begins --

11 A "Benefit designs"?

12 Q Yes. And the second sentence in that paragraph - and I will
13 read it. It says, "Premera will continue to make the
14 necessary investments to provide the state of the art
15 product designs as necessary to meet the demands of its
16 customers."

17 Did I read that accurately?

18 A Yes, you did.

19 Q Is this a commitment Premera intends to keep whether the
20 company converts or not?

21 A We certainly commit to bringing to the best of our ability
22 state of the art products, the product designs to meet the
23 needs of the marketplace, yes.

24 Q If you will look then also down on - let's see - the last
25 paragraph on that page. It is the first sentence and the

1 second sentence and I'm going to read them. "Premera has
2 experienced and anticipates significant organic growth in
3 the future. In order to foster and support such growth,
4 significant capital is needed to develop new products,
5 enhance service and launch sales and marketing efforts."

6 Did I read those two sentences accurately?

7 A Yes, you did.

8 Q In what ways will Premera's ability to foster and support
9 growth be impeded if it remains a nonprofit?

10 A The risk-based capital requirements of the company are
11 effected by membership growth. For every new member added,
12 we need risk-based capital for that member. So to the
13 extent that we add a significant number of members, we would
14 start to bump into the constraints of risk-based capital
15 that we have.

16 As you - as I explained earlier in my testimony, we are
17 at 433 percent risk-based capital and the Blue Cross/Blue
18 Shield Association monitoring level is at 375 percent. And
19 we are trying to avoid getting anywhere near that, anywhere
20 nearer than we already are.

21 Q Would you characterize the growth Premera has experienced
22 since 1999 as planned or unplanned?

23 A We planned to grow. How much growth you actually achieve is
24 dependent upon the marketplace, many factors in the
25 marketplace. To put on exact number on what we planned to

1 grow to at the start of 19- - I'm sorry - at the end of
2 1999, at the start of 2000, I cannot remember, but we
3 certainly intended to grow.

4 Q So I gather from your responses that you don't really feel
5 like you can characterize it one way or the other; is that
6 right?

7 A That's not correct. What I said is we intended to grow.
8 What the exact number that we planned, in other words, that
9 we projected in our forward-looking projects that we prepare
10 from time to time, generally look three years out - we
11 wouldn't have looked all the way out to 2004 at the end - to
12 the end of 2003. Maybe - no, we wouldn't have. We - it is
13 a three-year plan, so it would have taken us to the end of
14 2002.

15 So at the start of this period, we wouldn't have had a
16 set number, I don't believe, for 2004. I don't believe we
17 would have. Sorry. Yeah, for the end of 2003, but we did
18 plan to grow.

19 Q If you will look - turn to page 36, please.

20 A (Complying.)

21 Q Have you located the page, sir?

22 A I have got the page, 36.

23 Q Page 36. If you look at the last sentence on that page, I'm
24 going to read it. "As Premera considered its capital
25 alternatives, it categorically rejected mergers or

1 affiliations which jeopardized local economy and in turn
2 jeopardized the plan's ability to properly respond to local
3 market needs and expectations."

4 Did I read that correctly?

5 A Yes, you did.

6 Q Would you concede that management and the board of directors
7 of a public company have the duty to shareholders to
8 consider all potential credible merger or affiliation
9 opportunities that could result in enhancing the value of
10 the company's stock?

11 A Well, I'm not a lawyer. My understanding is that if an
12 offer is made by another company to acquire the company's
13 stock, the board would be obligated, in my assumption, to
14 look at it, but not necessarily to pursue it under
15 Washington law of which we have filed.

16 Q Do you have a copy of your - of P-4, your prefiled direct
17 testimony in front of you, sir?

18 A Yes, I do.

19 Q Would you take a look at Page 11?

20 A (Complying.)

21 Q If you look at the last sentence in the --

22 JUDGE FINKLE: Give us a second to catch up.

23 MR. HAMJE: Certainly.

24 JUDGE FINKLE: What volume is that going to be in,
25 do you know?

1 MR. HAMJE: This would be Premera Exhibit P-4. It
2 should probably be in the first of Premera's exhibits -
3 binders.

4 JUDGE FINKLE: Here we go. Got it.

5 MR. HAMJE: And I'm asking to direct your attention
6 to Page 11, please.

7 Q (BY MR. HAMJE) Mr. Barlow, the last sentence of the first
8 paragraph reads, "But it will take ongoing investments to
9 meet the evolving needs and expectations of our customers."

10 Is that correct?

11 A Yes, it is.

12 Q If there is no conversion, do you expect that Premera will
13 be able to meet the evolving needs and expectations of its
14 customers?

15 A It depends on the time frame you are looking at. I believe
16 that in the next few years, yes, but the marketplace doesn't
17 stand still. Our competitors are well-capitalized and
18 getting better so, so I believe that as we look out to the
19 future, we need to have capital resources and access to
20 those capital resources to be able to compete in the
21 long-term and to honor the intent of that sentence.

22 Q When you talk about your competitors, who are you thinking
23 of?

24 A For-profits and not-for-profits alike. We compete against
25 Aetna, United Healthcare, Cigna, among others. We also

1 compete against Regence. Regence, as you know, is a
2 nonprofit and is affiliated across state lines with several
3 other - with several other states. They are pretty
4 well-capitalized, better capitalized than we are.

5 Looking at the for-profits, clearly they are very
6 well-capitalized and very large, so they will - they do have
7 the resources to continue to develop products and services
8 against which we must compete.

9 Q Do you monitor Premera's profit and loss by line of
10 business?

11 A We do. The principal way we monitor Premera's profitability
12 is as a portfolio of products. If you look at any specific
13 line of business at any particular time, it may be above or
14 below expectations set for the line, but overall - over our
15 million-and-and-a-half or so members, we expect our
16 profitability to be attained.

17 Q When you talk about portfolio of products, does that mean
18 that you also monitor profit and loss by product line?

19 A We do - we monitor by product line and by size of group, if
20 that is your question. The greatest distinction is around
21 the market segments, which would be individual, small group
22 and large group and then by state.

23 Q What about by products, do you look at the profit and loss
24 by products as well?

25 A We look at the profitability of products, yes.

1 Q Is it just on an occasional basis or is there a regular
2 periodic review of - or accounting with respect to that?

3 A Well, if you - if we look at the individual line, for
4 example, there is a split between individuals under 65 and
5 those over 65 who we serve through our mid subproducts. So,
6 yes, we do have profitability of those though discreet
7 segments within the individual line of business.

8 Q Do you also do it for the group lines, small group, large
9 group?

10 A Could you give me an example of what you are driving at?

11 Q Do you - are you - well, I will try to. Do you look at a
12 particular product to try to determine whether it is
13 generating surplus or not?

14 A Well, for example, if you - we looked at our HMO product
15 line that is a product in and of itself which covers various
16 segments of the population and determined that was not a
17 viable product line for the future for many different
18 reasons and so we have - yes, we have monitored its
19 profitability and we have cut back our membership in that
20 product line --

21 Q Okay.

22 A -- because it is very expensive to offer.

23 Q Are you aware of any expressions of interest, formal or
24 informal, by any party to acquire or seek an affiliation
25 with Premera?

1 A The - I can think of a lot of talk in the industry from time
2 to time, but the only specific incident that I can recall
3 now is in my tenure at Premera was when we were approached
4 in terms of an affiliation by Regence or a representative of
5 Regence, not Regence directly. And I had a discussion the
6 CEO of Regence, Mr. Walworth (phonetic), that was more along
7 the lines of, "Well, if your conversion doesn't work out,
8 you know, let's talk."

9 He is retired at this point, so I guess we won't be
10 talking no more than - other than social conversation. So
11 that's the - I can't think of another instance of anybody
12 asking us to affiliate in any way.

13 And I must - just to be very precise, it was a very
14 preliminary advance made by this person on behalf of
15 Regence. And after, Mr. Walworth and I had a more casual
16 conversation a few months later. And I can't remember the
17 exact date. He did approach me. And, in fact, we wrote a
18 letter to him, which I think is on the record with you,
19 saying that we were not interested.

20 Q I gather from your testimony that remaining an independent
21 local company is important to achieving Premera's mission;
22 is that correct?

23 A We - we believe it is. We believe it is the best way that
24 we can serve our members through having local management and
25 responsiveness that comes from having local management.

1 Q And this distinguishes Premera from companies that are
2 directed from far off headquarters; is that right?

3 A It certainly does. And it is helpful to us in the
4 marketplace. It certainly is not the only thing that people
5 look at. They want to know - you know, they don't care
6 where your headquarters are if you are not responsive. So
7 that's helpful. But they also need to have each product
8 priced to meet their needs.

9 Q I also understand that you believe that Premera provides
10 superior service to its members in part because you and your
11 employees live and work in this community; is that right?

12 A I believe that is correct.

13 Q Is this based upon any empirical data?

14 A It is based on my own experience in the marketplace more
15 than putting out a specific research on this topic. But I
16 think as I speak to people, they do acknowledge the
17 experience of the local management.

18 In fact, when we won the Microsoft account, which is, of
19 course, the premier win over the last few years with any
20 health plan in the state, they did cite the fact that they
21 would have access to management here in Seattle.

22 Q That was one of the factors that led to your decision?

23 A That was one of the factors, not the only factor. They
24 looked at the technology and the service that we would bring
25 and the kind of network we would bring and the cost of that

1 network.

2 Q Now, I understand that Premera has also ventured into the
3 health plan market in Arizona with its subsidiary of
4 LifeWise Health Plan of Arizona; is that correct?

5 A That's correct.

6 Q Has that plan started to market products yet?

7 A Yes, it has. We were effective, I believe, on the 1st of
8 April and have started to sell members. It is going to be
9 sometime before we can tell how successful we will be.

10 Q Is LifeWise of Arizona competing with independent local
11 health plans in Arizona?

12 A It is competing with the full marketplace. The marketplace
13 is - the biggest health insurance or health plan is Blue
14 Cross, but it's quickly followed by, I believe, United and
15 Cigna. Aetna has a large presence there. HealthNet has a
16 large presence there. Pacificare has a presence there. So
17 there is a pretty wide array of competition from the local
18 Blue as well as national plans. And I'm sure other - other
19 local plans besides the nationals that I have mentioned.

20 Q Is it your experience that the independent local Blue in
21 Arizona provides superior service to its customers in part
22 because - because they are local as compared to LifeWise of
23 Arizona?

24 A You know, I would not characterize the kind of service that
25 they provide. I cannot say that I have researched that.

1 They certainly are competitive in the marketplace and do
2 pretty well, but they are not a - as large a - they have got
3 the both the Blue Cross and the Blue Shield licenses there.
4 In our major market share in Western Washington we only have
5 Blue Cross, as you know. And normally plans that have both
6 Blue Cross and Blue Shield tend to have a larger share of
7 the marketplace than the Blue plan of Arizona does.

8 Q What can be done by Premera to ensure that because LifeWise
9 of Arizona's activities are being directed from Mountlake
10 Terrace it does not affect quality of service that it offers
11 to Arizona members as compared with local Arizona health
12 plans?

13 A That's a good question. Our strategy is to have general
14 managers who are vice-presidents of the company in every
15 major market that we serve. So - and that model has worked
16 well. So we have a general manager who is responsible for
17 the marketplace. We have one in Alaska. We have one who is
18 actually the CEO of LifeWise of Oregon and we have general
19 managers in Washington.

20 That kind of attention from a person - an officer of the
21 company, I think, provides the responsive access to the
22 company that is demanded by the marketplace, especially the
23 kind of market that we are going after in Arizona, which is
24 the small group market at this point.

25 We also have local customer service in - in the

1 marketplaces that we serve. We have our healthcare delivery
2 systems, in other words, our provider relations people in
3 every major market that we serve, Western Washington,
4 Eastern Washington, Arizona, Alaska, Oregon. We have sales
5 people in every market that we serve, local market. So we
6 think that this does provide the local touch of the market
7 that is needed in each marketplace that we serve.

8 Q If Premera were acquired by an out-of-state company, would
9 it be possible that some - that this particular model, or at
10 least a portion of it, could be utilized to maintain the
11 standard Premera has set for superior service to its members
12 in Washington even though it is being directed by an
13 out-of-state?

14 A It really - it's possible. It is not impossible. I think
15 the way we set it up, we can do better, but I won't say that
16 it is impossible for another plan to acquire Regence and do
17 what --

18 Q I want to explore this a little bit longer with you. And I
19 think - let me start off by asking kind of a general
20 question. I think you have come up with a couple of
21 reasons.

22 Besides from having a better understanding of the needs
23 of your customers and providing superior service, are there
24 any other reasons why you believe it is important that
25 Premera remain local and independent?

1 A The - all we do at Premera is around serving our mission,
2 providing peace of mind to our members about their
3 healthcare coverage. How we serve them best changes over
4 time, but the most effective way that we see today, and I
5 believe for the future, is to be modeled in the way that we
6 are, to be headquartered here in Washington, serving the
7 major market that Premera serves, which is Washington.

8 As you saw before, most of our membership is in
9 Washington. I believe it is very important to - to serve
10 this marketplace because we are in touch with the
11 marketplace.

12 Q If Premera converts and is subsequently acquired by another
13 company, is it possible that a question would arise about
14 you remaining in your position at Premera?

15 A I guess it would depend - that's a pretty big hypothetical
16 because, you know, the board has determined the other way,
17 that we are going to remain independent. So assuming that
18 the board hypothetically decided that they wanted to sell to
19 somebody else, it would depend on that somebody else as to
20 whether they wanted me to serve.

21 You know, I serve at the pleasure of the board and if
22 another company took us over, I would serve at the pleasure
23 of that next board.

24 Q I presume that this possibility is not a consideration with
25 respect to Premera - Premera remaining a local, independent

1 company; is that right?

2 A Which consideration?

3 Q The possibility if it is acquired that your remaining in
4 your position might become an issue, might become a
5 question.

6 A I'm not clear as to what you are driving at. It is - is the
7 fact that we want to remain local determined by the fact
8 that I want to remain on as CEO? Is that your question
9 because that, you know --

10 Q I'm saying - what I'm saying is that is not a consideration.

11 A Well, it might be a consideration for me personally, but the
12 board doesn't take that into consideration. The board acts
13 as the fiduciary of the company to determine what best
14 serves the mission of the company and they have determined
15 that our current strategy is the right one for Premera and
16 our members.

17 The fact that I happen to be the CEO is, I think,
18 incidental to their determination. Obviously I'm happy that
19 they made that determination, but I agree with it, too.

20 Q I want to move on now to the Blue Cross/Blue Shield
21 Association license requirements. We have been - we have
22 been talking about them, but we really - at least I don't
23 really think there has been any real discussion of exactly
24 how they impact what we are doing here today, what we are
25 talking about with respect to the proposal.

1 And could you describe generally your understanding of
2 what the stock ownership requirements are with respect to
3 the Blue Cross/Blue Shield Association? And when I say,
4 "stock ownership," I'm talking about a public company.

5 A Right. My understanding of the Association's rules are that
6 in general a licensee must have no stockholder with more
7 than a five percent interest in the stock - five percent -
8 yes, a five percent interest in stock of the company other
9 than an institutional business who could have as much as 10
10 percent of the stock of the company.

11 They make exceptions to that basic rule in granting - in
12 approving a conversion for - for the company in that it
13 gets - as I was saying, an exception to that basic rule so
14 that we can have the foundation that owns more than five or
15 10 percent. And I believe that the foundations are not
16 institutions as defined and so over time they require that
17 the foundation stock be sold down to that five percent
18 level.

19 Q And that - and now you are speaking of the divestiture
20 requirement; is that right?

21 A Well, I'm talking about the requirements that no individual
22 or - no investor has more than five percent other than the
23 institutions of which I believe the foundations are not
24 constituted to be an institution. An exception has to be to
25 granted to that broad-based rule for foundations so that

1 they can sell this stock off to get to the level that has
2 been dictated by the rules.

3 Q Is there a specific schedule that is involved in that
4 exception?

5 A I believe the schedule is that the foundation should own no
6 more than 80 percent of the stock after one year and I
7 believe it is 50 percent after three years. I'm not certain
8 of the schedule, but it is along those lines. And now I
9 understand that it goes as long as 10 years to get down to
10 five percent. I think that that's correct.

11 Q Can you - well, let me ask you this first: Do you have -
12 hold a position with the Blue Cross/Blue Shield Association
13 as a representative of Premera?

14 A Yes. I'm on the board of directors of the Blue Cross/Blue
15 Shield Association, one of 42, I believe.

16 Q Do you serve on any committees?

17 A Yes, I do.

18 Q Which ones, please?

19 A The Interplan Programs Committee and the Brand Committee.

20 Q Do you hold any offices with the Association?

21 A No.

22 Q Have you ever?

23 A No.

24 Q Can you explain the underlying rationale for this - these
25 requirements with respect to stock ownership that are

1 promulgated by the Blue Cross/Blue Shield Association?

2 A Well, I would have to preface it by saying that I was not
3 around by quite a long time when the rules were established.
4 I didn't even belong to a Blue. I worked for HealthNet when
5 they were established. I believe that they were established
6 when WellPoint converted in '94, thereabouts.

7 But my understanding of this Blue rule, which - with
8 which I subscribe, if this is correct, is that the brand
9 needs to be protected by any investors who may have a
10 short-term view, an interest that is divergent from taking
11 the best care of the members that you serve. So obviously
12 an investor, such as a foundation, which has the obligation
13 to maximize the value of the stock as they sell it down, is
14 perhaps - and they - normally foundations want to sell it
15 down so that they are not invested just in one stock. They
16 want to sell it down quickly so that they can diversify
17 their portfolio.

18 Those interests may be divergent from the long-term
19 needs and interests of the members that we serve. So I
20 believe that that is why it was established that there
21 should be no outside large stockholder who might be - might
22 have the interests of the members specifically at heart,
23 should not dictate to the board of directors of the
24 individual Blue plans that have converted how to take the
25 interest of the members and the brand to heart.

1 Q I wanted to ask you about - continuing along with questions
2 about the Blue Cross/Blue Shield Association, when did
3 Premera first present to the Blue Cross/Blue Shield
4 association this proposal or the intention that Premera
5 intended to propose this conversion?

6 A We were very careful in the first instance after our board
7 determined to convert to the proposed conversion to approach
8 the Insurance Commissioner and the Attorney General and the
9 Governor of our state. Soon thereafter I believe I made a
10 phone call to the CEO of the Blue Cross/Blue Shield
11 Association to inform him that we were proposing to convert
12 and I believe I recall Mr. Milo, our chief legal officer,
13 writing to the general counsel of the Association to inform
14 him soon after.

15 Q Did you - prior to the time that you spoke about in your
16 prefiled direct testimony and also have summarized today
17 during your testimony, that you presented the issues to the
18 committee at the Blue Cross/Blue Shield Association --

19 A The Plan Performance Financial Standards Committee.

20 Q -- had you taken any steps prior to that time to submit
21 these types of issues to the committee or to the Blue
22 Cross/Blue Shield Association?

23 A The - my staff had been in conversation, as I understand
24 from them - I know that they were - with the committee -
25 sorry - with the staff that supports the PPFSC. And I don't

1 know exactly when those conversations started, if the PPFSC
2 staff had received a copy of our filing. I can't tell you
3 exactly when we sent it to them.

4 Q Would you characterize those conversations as essentially
5 being informal communications?

6 A Well, I think communications.

7 Q Well, I guess what I'm getting at is whether there was any
8 type of a formal filing with the Blue Cross/Blue Shield
9 Association?

10 A I honestly can't characterize whether it was formal or
11 informal. They received the Form A from us, as I understand
12 it, and reviewed it and had comments back to us on the Form
13 A of the issues that they saw in it.

14 Q Did you take --

15 A And so they were aware of the issues that were relative to
16 our filing and the items that I'm certain they discussed
17 with our staff, and some of which are still under
18 discussion. And they were aware of our request relative to
19 the three duplicate foundation rights issues because we
20 raised it with them first. They said they would not - they
21 could not recommend it to the committee.

22 So they were fully aware in terms of what we wanted.
23 And so we filed, as I explained earlier, a Form A - the
24 Amended Form A without taking into account the three - the
25 three principal changes around the duplicate foundation

1 rights, and we then appealed to the PPFSC itself.

2 Q So prior to that - you know, that submission that you made
3 to the committee, you made - other than having shared
4 information about the - about the Form A and received
5 comments, you had - you had taken no steps; is that right?

6 A Me personally?

7 Q Well, Premera.

8 A That's correct. I'm not aware of us - there may have been
9 other conversations where other people went back there. In
10 fact, I believe that there were. I can't remember exactly
11 when. Back to Chicago. But I personally was not involved
12 in direct conversations other ones - other than the ones
13 that I have described that I can recall.

14 Q I would like you to make an assumption for just a second in
15 connection with this question. If Premera were to lose the
16 license for whatever reason or if for instance the
17 Association may waive the regulations with respect to the
18 stock ownership and divestitures of public companies, would
19 Premera be willing to remove the stock restrictions and
20 divestiture requirements from the Form A?

21 MR. KELLY: I have to object to that. It is two
22 mutual contradictory assumptions. One or the other.

23 JUDGE FINKLE: Rephrase, please.

24 Q (BY MR. HAMJE) Well, let's start with this: Let's just
25 assume for a moment that the Blue Cross/Blue Shield

1 Association waived the restrictions on stock ownership with
2 respect to the public company.

3 A Are you talking about the duplicate foundation rights?

4 Q Well, let's start there. Let's talk about the duplicate
5 foundation rights. Let's talk about the divestitures being
6 an aggregate divestiture.

7 A Those are the duplicate foundation rights.

8 Q Okay.

9 A Those are embodied in the duplicate foundation rights.
10 Those are three. Those are one of the three. So if the
11 Blue Cross/Blue Shield Association removed those
12 requirements, the question to me is would we go - would we
13 be prepared to amend our Form A to allow for those duplicate
14 foundation rights from Premera's point of view? Is that
15 your question?

16 Q Yes, sir, let's start there.

17 A Yes, we, in fact, are agreeable to these - these three
18 specific items and advocated for them before the PPFSC. We
19 wouldn't have done so if we didn't believe in it.

20 Q Mr. Barlow, I wanted to turn now to the Vicardy (phonetic)
21 versus AHI lawsuit. Do you know what I'm talking about when
22 I mention that?

23 A There was a lawsuit against AHI, yes.

24 Q And this is part of the Form A that is located in Exhibit
25 A-6 and I - unless you want to refer to it, I just wanted to

1 ask you some general questions about it. If we need to, we
2 can go ahead and take a break and make a copy of it for you
3 to review.

4 A I'm not sure what you are talking about. In the Form A?

5 Q Yes. There was mention of it in connection with your
6 biographical affidavit.

7 A Okay.

8 Q Do you - you were sued in that case as a defendant; is that
9 correct?

10 A Yes, sir.

11 Q Can you - would you please generally describe the nature of
12 the suit?

13 A Yes, I can. The suit against AHI and certain of its
14 officers and directors arose out of the company going public
15 and in essence not meeting its expectations of stockholders
16 and the stock fell. Soon thereafter - in fact, I think the
17 day after, a class action lawsuit was filed. And that, I
18 believe, is the - the Vicardy --

19 Q Vicardy --

20 A Vicardy was part of that class action lawsuit.

21 Q Was the registration statement at issue?

22 A Yes. What, as best as I can understand, was at issue was
23 the company had included in the registration statement - I
24 think the real reason, if you - just to back up, is that the
25 stock price fell. As is the nature of these kinds of

1 lawsuits, the attorneys for the plaintiffs went through the
2 registration statement and we had announced that a small
3 acquisition, which I believe was for Lakewood, it was a
4 medical group, that had been included at the insistence of
5 our accountants and lawyers and I believe the SCC on a pro
6 forma basis on the S-1 of the prospectus, that that was the
7 subject of an LOI, which was obviously made clear in the
8 prospectus.

9 We announced that deal had, in fact, fallen through and
10 so what was at issue was whether we should have disclosed
11 that the deal was on shaky grounds.

12 The officers and directors of AHI did no wrong and
13 asserted that, but settled the case out of the uncertainties
14 that are intendant with lawsuits and the time and expenses
15 that are intendant with that kind of lawsuit.

16 Q Did you sign or prepare the registration statement that was
17 at issue?

18 A The company - I joined the company in - I believe I started
19 on July 10th of 1995. The company had already filed its
20 registration statement before I joined. In subsequent
21 amendments to that registration statement, I - I was
22 involved and did sign. The company, between the time I
23 joined in mid July, went public the 28th of September or
24 thereabouts of 1995, so about two-and-a-half months later.

25 Q Was your signature for the purpose of vouching for the

1 accuracy of the information contained in the statement?

2 A Yes.

3 Q And to the best of your --

4 A To the best of my knowledge, yes.

5 Q And to the best of your knowledge, was the information
6 accurate?

7 A It was certainly.

8 Q Was any action taken by SCC or any other regulatory or
9 governmental authority in connection with the matters
10 alleged?

11 A No. There were no actions taken by the SCC, at least none
12 to my knowledge, not against the company.

13 Q Or against you?

14 A Nor against me.

15 Q Or any of the other defendants?

16 A Or against any of the other defendants.

17 Q And were you required to contribute any of your personal
18 funds to the settlement?

19 A No, I was not.

20 Q Were there any other consequences to you arising from this
21 case and its resolution?

22 A Well, none directly related to the case. I personally
23 invested in the stock of the company and lost some of my
24 principal, but beyond that, no.

25 Q I wanted to go on to another lawsuit and just ask . . .

1 MR. HAMJE: Well, it has been almost two hours now
2 for Mr. Barlow.

3 JUDGE FINKLE: How much longer do you expect to be?

4 MR. HAMJE: Oh, I could - I think I could go another
5 45 minutes to an hour possibly.

6 JUDGE FINKLE: You could and you expect to; is that
7 what you are saying?

8 MR. HAMJE: Pretty much expect to.

9 JUDGE FINKLE: Okay. Let's take a break. Fifteen
10 minutes.

11

12 (Brief recess.)

13

14 JUDGE FINKLE: Let's resume. Mr. Hamje, please
15 continue.

16 MR. HAMJE: Thank you, Your Honor.

17 Q (BY MR. HAMJE) I wanted to revisit the question - just for
18 a moment - the question of - about the Blue Cross/Blue
19 Shield Association. The Form A exhibits an Exhibit G-4,
20 which is the voting trust and divestiture agreement. Do you
21 recall that document?

22 A Not specifically, no.

23 Q Okay.

24 MR. HAMJE: Could we just take a copy of it real
25 quick and show it to him? It is Exhibit G-4 in the revised

1 Form A.

2 MS. SUREAU: Great. Thanks, Christine.

3 MR. HAMJE: May I approach the witness?

4 JUDGE FINKLE: Yes.

5 Q (BY MR. HAMJE) Mr. Barlow, I'm going to hand you this
6 binder that is opened to the first page of Exhibit G-4 and I
7 just would like you to take a look at it and tell me whether
8 by looking at it you have a - your recollection is refreshed
9 about it.

10 A (Perusing.)

11 I'm sure I may have asked and answered it, but I'm not
12 familiar with that document.

13 Q Okay. That's what I wanted to find out. Thank you, sir.

14 MR. HAMJE: Thank you.

15 MS. SUREAU: You're welcome.

16 Q (BY MR. HAMJE) Mr. Barlow, do you - does Premera pass along
17 to subscribers every increase in operating costs?

18 A We attempt to include in our rating all the costs that we
19 incur as a normal practice, yes.

20 Q Do you pass along every increase in provider reimbursements
21 as well?

22 A Yes, we do.

23 Q If you turn it around - let me ask it this way: Do you only
24 increase provider reimbursement if you can pass the cost on
25 to subscribers?

1 A The answer is a little bit more complicated than a straight
2 yes or no. We have to estimate whether the inclusion of a
3 specific provider that may be demanding an increase is going
4 to be acceptable to our members and it will contract and
5 attempt to pass it on to the subscribers at the time of the
6 next renewal.

7 MR. KELLY: Excuse me. I think inadvertently we are
8 picking up the noises of the typing, as least I think I can
9 hear it.

10 JUDGE FINKLE: I think it is going to be the other
11 speaker, if you can move that. Thanks. Is that better?

12 MR. KELLY: Fine. Thank you.

13 Q (BY MR. HAMJE) If I could ask Mr. Barlow to take a look at
14 the exhibit marked P-37, which is Mr. Ansel's prefiled
15 direct testimony.

16 MR. HAMJE: I just want to make sure that the
17 Commissioner and Judge Finkle also have it.

18 JUDGE FINKLE: Thank you.

19 MR. HAMJE: That's Exhibit P-37, Page 3.

20 Q (BY MR. HAMJE) Mr. Barlow, are you on Page 3?

21 A Yes, sir.

22 Q Okay. Thank you, sir. If you would look at the last
23 paragraph that starts on that page, the second sentence
24 reads, "Every demand for higher payment levels by providers
25 has a direct impact on the premiums our policyholders have

1 to pay."

2 Is that an accurate statement?

3 A Yes, it is.

4 Q Why is that, sir?

5 A Because we run with the very narrow operating margin, as I
6 have described earlier. And so to the extent that it's at
7 least four percent of the premium dollar is spent on
8 healthcare costs, so to the extent that there is an increase
9 in one of the components of healthcare costs, we will strive
10 and need to pass those costs on to our subscribers.

11 Q Do you also pass on to the subscribers every reduction in
12 savings as well?

13 A Yes, we do.

14 Q With respect to the designated member on the New Premera
15 board of directors, I understand that Premera will retain
16 the right to reject all nominees by the Washington
17 foundation to the board even if they meet the applicable
18 requirements; is that - is that understanding correct?

19 A That is correct.

20 Q Why is that?

21 A Well, the standard that we stride to get to in this was a
22 negotiation that had taken place in New York with the
23 WellChoice conversion where, as I understand it, our
24 consultants said that's the standard that you - you should
25 adhere to. And so that was - according to that standard, we

1 agreed to in the first place to have a board member from the
2 foundation. We don't believe that it was a requirement upon
3 us to have it, but we were agreeable in order to close the
4 gap between us and the perceptions that were being brought
5 forward by the state consultants.

6 So that's the starting point. We agreed to have a
7 director. We felt if we are going to have a director, it
8 should be somebody that at least is going to be, A,
9 qualified, and B, have some comparability to other board
10 members. So we felt it was important that we have an
11 ability to be presented with candidates and then to be able
12 to put our governance committee - independent governance
13 committee to make a determination as to whether that slate
14 of directors would fit with the organization - I'm sorry -
15 with the board.

16 Q Does Premera also retain the right to reject the director
17 nominated by other shareholders?

18 A I can't answer that. That's a securities law question that
19 is just beyond what I came prepared to address today.

20 Q The proposal also contains provisions that Premera be given
21 12 months to complete the transaction after receiving all
22 the regulatory approvals; is that correct?

23 A That's my understanding.

24 Q And it also provides that Premera can seek additional
25 extensions from the Commissioner; is that right?

1 A That is correct.

2 Q And my understanding is that the state's consultants have
3 agreed to Premera having the ability to come to the
4 Commissioner to seek extensions; is that right?

5 A That's my understanding.

6 Q But Premera also desires to have two automatic successive
7 three-month extensions as well if there is litigation
8 pending; is that right?

9 A That's right.

10 Q Why can't that same policy be served by just seeking
11 additional extensions from the Commissioner without the
12 necessity of having automatic extensions?

13 A Mr. Hamje, you have seen how expensive the process is in
14 getting to where we are today. Obviously if we are going to
15 get permission from the Commissioner, the Commissioner has
16 to do his due diligence of granting that permission, which
17 will require additional costs, which we would like to avoid.

18 MR. HAMJE: At this point, I do have a few more
19 questions, maybe another 20 minutes, maybe a little bit more
20 depending upon the length of the responses, but these are
21 particularly - these are items that may very well be
22 considered to be confidential propriety information or could
23 elicit responses regarding those. And so my understanding
24 was that we should bring that to the attention of the
25 Commissioner and the Special Master to make an appropriate

1 determination of maybe closing the hearing at that point in
2 time.

3 JUDGE FINKLE: Any comment?

4 MR. KELLY: I think that's fine. I guess - yeah, I
5 think that's probably most sensible, unless we could do the
6 cross of the others before that, but . . .

7 JUDGE FINKLE: Well, I don't want to open and close
8 the hearing more than is necessary.

9 Have you concluded your questioning in other areas?

10 MR. HAMJE: Well, there - there is some overlap, but
11 the questions that I reserved were those that would -
12 potentially a response will result - if Mr. Barlow were to
13 speak candidly, as I would like him to do, could result in
14 revealing confidential proprietary information. So that's
15 all that there is left. There are several subject matters,
16 but there are just those questions that might elicit those
17 types of response.

18 JUDGE FINKLE: Any input from the Intervenors?

19 MR. MADDEN: I think we would like to hear Mr. Hamje
20 complete his cross-examination and follow him.

21 MR. KELLY: I guess the only thing I would ask is
22 that we do the cross by Mr. Hamje in camera, then any cross
23 on that subject by the Intervenors in camera, and redirect
24 by us in camera and then be done with the in camera.

25 JUDGE FINKLE: Actually, at that point, I will ask

1 the Intervenor whether there are additional areas in camera
2 so we can avoid - you may be able to persuade me otherwise,
3 but I really want to close the hearing only once for this
4 witness if we can.

5 MR. MADDEN: Oh, we certainly agree. And without
6 knowing where Mr. Hamje is going, I have already alerted
7 counsel that I intend to direct the witnesses's attention to
8 a document that is designated confidential, but I intend to
9 examine him about a portion of it which I don't believe by
10 any stretch could be considered so, and so they can make
11 their decision on whether any of mine needs to be closed. I
12 have informed them which exhibit it is.

13 MR. KELLY: I don't see that as a problem.

14 JUDGE FINKLE: Okay. Let's close the hearing at
15 this point for as limited a session as possible consistent
16 with the need to preserve confidentiality.

17
18 (Brief recess.)

19
20 JUDGE FINKLE: Okay. We are reopened. Mr. Madden?

21 MR. MADDEN: Thank you, Your Honor.

22
23 CROSS-EXAMINATION

24
25 BY MR. MADDEN:

1 Q Good afternoon, Mr. Barlow. Did I understand Ms. Jewell's
2 testimony correctly that the last time that Premera found
3 itself in - in straights regarding its RBC that the solution
4 proposed was the MSC merger, the Medical Service Corporation
5 merger?

6 MR. KELLY: I will object. I don't think that
7 fairly restates the evidence.

8 JUDGE FINKLE: Sustained.

9 Q (BY MR. MADDEN) Well, let me remove the predicate.

10 Mr. Barlow, were you with the company at the time that
11 the MSC merger was consummated?

12 A I was.

13 Q Okay. And was that merger done in response to a perceived
14 need for additional capital on the part of Premera Blue
15 Cross?

16 A The merger took place to consolidate the capital of MSC and
17 Blue Cross of Washington and Alaska, which is the - and the
18 company is now Premera Blue Cross. The two companies were
19 previously affiliated as two independent companies under the
20 Premera balance. It was a holding company, but we were
21 affiliated.

22 Q But the merger had the effect, did it not, of improving the
23 Premera Blue Cross's RBC?

24 A At the time it was not RBC, it was a capital benchmark, but
25 the equivalent. The consolidated companies' RBC was

1 improved, yes.

2 Q Okay. Thank you.

3 How much capital does Premera itself expect to raise
4 through its proposed IPO?

5 A We would prefer to raise in the range of about 150 million
6 dollars, but it will depend on a lot of the things, on the
7 state of the market the at the time that IPO will take
8 place.

9 Q We heard you mention that the company has to engage in - I
10 think what you referred to as trade-offs when it comes to
11 enhancing its capital reserves versus investing in
12 infrastructure in new products; correct?

13 A The company always has to evaluate every project and they
14 always - there is always competition for the available
15 resources, whether it is capital or otherwise within the
16 organization.

17 Q And that's not unusual in any company, is it?

18 A No, it's not.

19 Q Now, in the late 1990s, even after the MSC merger, your
20 capital reserves or RBC were lower than the current figure;
21 correct?

22 A That is correct.

23 Q But nevertheless --

24 A Actually, I take that back. Excuse me.

25 Q Okay.

1 A That is not correct. I can't recall the exact numbers, but
2 there was a change in the measurement from the capital
3 benchmark to risk-based capital and I can't remember the
4 exact trajectory. But when we first changed to risk-based
5 capital, we were fairly high, whatever year that was. And
6 it was in the 400s, as I recall it.

7 Q Mm-hmm.

8 A I'm sure we have that in the - in the prefiled testimony. I
9 think - well, we have it somewhere in the documents that
10 have been provided to the state's consultants. It then - so
11 I'm not sure that it was lower than it is today is the
12 bottom line of my answer. It may have been a bit higher. I
13 just cannot recall exactly.

14 Q When was it that the company first got the okay from the
15 board to go forward with the Dimensions project, or the BEST
16 project as I understand it was called earlier?

17 A In August 2000 approximately.

18 Q And that's a project that I believe you indicated has cost
19 you approximately 125 million dollars?

20 A It has cost 125 million dollars. Not all of it was charged
21 against our risk-based capital.

22 Q How much was charged to RBC?

23 A I don't have the number, but we did - as Ms. Jewell
24 indicated, we did enter into lease-back transactions that
25 effectively had synthetic leases that got - financed some of

1 the - those costs.

2 Q What was Premera Blue Cross's RBC at the time the board
3 decided to go forward with the Dimensions project?

4 A It was over the minimum. I don't remember what it was. It
5 was - I say the minimum - over the early warning level of
6 375.

7 Q So is this one of the trade-offs where the company decided
8 that it was more important to go forward at that point with
9 the Dimensions project and put capital into it and take the
10 hit, if you will or to put it another way, perhaps not take
11 a hit, but not be able to enhance capital reserve ratios
12 somewhat?

13 A We looked at the investment, cash flows and the expected
14 paybacks from investing in the project and determined, based
15 on our projections, that we would be able complete the
16 project without actually going under the early warning
17 level. Not without risk obviously, because projects are
18 just that. It is not a certainty, but we did estimate that
19 we were capable of completing the project without going
20 below the required early warning level.

21 Q Mm-hmm. To your knowledge, when is it that Premera
22 management first talked about the possibility of converting
23 the company to a for-profit stock entity?

24 A From my personal knowledge?

25 Q Yes.

1 A The first time I recall having any discussion about it was
2 in about May or so of 2001. The - in other words, starting
3 on this, progressing down this path. And it was no so much
4 talking about conversion, but saying we needed to reevaluate
5 our capital options.

6 And so we had - just going back on the history, back to
7 1977, which is just after I joined the company - 1997, I
8 apologize - when I joined the company, we had had Goldman
9 Sachs who had come in and done an evaluation of what our
10 options were at that time. And the board - we reported our
11 risk-based capital throughout the period subsequent to the
12 time that Goldman Sachs had been in 1997 and early '98 when
13 we merged the two companies. But capital has always been on
14 the mind of the board. Are we adequate or are we not?

15 One of the thoughts had been that we should look at
16 immediately after closing that - just as an example, just
17 after we closed that merger between MSC and Blue Cross of
18 Washington and Alaska to examine whether we could raise
19 subordinated debt and so we did actually look at that. And
20 that's an example of how the board was always concerned that
21 we needed to monitor our capital.

22 So we started to make slow progress, but it was always
23 something we needed to watch. As the new CEO, I felt it was
24 important that the board be informed of how we might again
25 look at capital raising alternatives and - but we hadn't

1 kept track with Goldman or anybody else as to what were the
2 real possibilities for the company in any way that - we
3 found subordinated debt at that time to be too expensive,
4 back in '98 or so.

5 So I spoke to the board and said I believe we should go
6 and see Goldman again. I believe I had a conversation with
7 probably Mr. Marquardt and Mr. Milo before telling the board
8 that I planned to do that at the main board meeting.

9 And said I wanted to go visit them and just talk about
10 the possibilities and ask them to come back and represent
11 what they previously presented because we obviously had some
12 turnover in the board through our normal board rotation
13 rules. And so the board could understand what was
14 previously presented and what the potential options were.
15 And they did that at the August meeting.

16 Q And when you say, "So the board could understand what was
17 previously presented," you are referencing the earlier --

18 A The '97 - the '97 presentations that were made by Goldman to
19 the board.

20 Q All right. Could you turn to the notebook of Intervenor
21 exhibits that is before you and turn to Tab 3? That is
22 Exhibit I-3?

23 A Turn to Exhibit I.

24 Q That's correct. I will ask you to hold on for just a second
25 while the Commissioner and Master catch up with us.

1 JUDGE FINKLE: What was the number?

2 MR. MADDEN: I-3.

3 JUDGE FINKLE: I-3.

4 Q (BY MR. MADDEN) Mr. Barlow, this is, as you have indicated,
5 a letter signed by you and Ms. Betty Woods dated February
6 17th, 2000, to Senator Pat Thibaudeau, chair of the Senate
7 Health and Long-Term Health Committee; correct?

8 A That appears to be correct.

9 MR. MADDEN: We would offer I-3 at this time.

10 MR. KELLY: No objection.

11 MR. HAMJE: No objection.

12 JUDGE FINKLE: Admitted.

13 Q (BY MR. MADDEN) Mr. Barlow, to put this in context, in the
14 2000 legislative session was there a measure introduced at
15 the request of Former Insurance Commissioner Senn bearing on
16 the topic of conversion of not-for-profit health carriers
17 that Premera was interested in?

18 A Yes, there was. As I recall it, she introduced legislation
19 in a short session of the legislature that we felt was being
20 rushed through and believed that the - and it was done right
21 at the end of the session, as I recall it, that - I take
22 that back - during the session, but in the short session in
23 2000, that this important topic needed full deliberation.
24 And so we advocated that a bill - consideration of the bill
25 be deferred until the next session, if at all.

1 Q And so in that regard you gave, as the letter stated, your
2 personal assurance that there was no basis to the
3 Commissioner's suggestion that Premera Blue Cross intended
4 to convert to a for-profit entity?

5 A That's correct. As I recall it, we had filed a for-profit
6 subsidiary to take care of our needs in - particularly in
7 Clark County where we do not hold the Blue Cross license.
8 And so to address that specifically, we had formed a company
9 and designated for-profit. And the Commissioner Senn jumped
10 to a conclusion that was incorrect, that somehow or another
11 we were going to use this subsidiary - actually, I shouldn't
12 assume what she did, but anyway, she did link that similar
13 version of which we had no intention at that time.

14 Q And in that regard, as the letter states on the second page,
15 you offered to give a commitment that Premera Blue Cross
16 would not convert from its current nonprofit corporate
17 status to for-profit status or transfer of control to a
18 for-profit entity between the time of the letter and the
19 close of the next legislative session; correct?

20 A Can I just have a moment to read the whole letter?

21 Q Certainly. Certainly.

22 A I have read the second to the last paragraph on that page
23 and I believe that we honored that commitment in full.

24 Q When - when did you expect the 2001 regular session to end?

25 A I believe it ends in May.

1 Q And when did your board make the decision to move forward?

2 A In 2002.

3 Q When did management bring Goldman Sachs back to the board?

4 A Goldman Sachs did not come to discuss a recommendation of
5 conversion in August of 2001.

6 Q When did Gold- --

7 A They only made a recommendation after due diligence in
8 September 2001 to examine the issue, not a recommendation to
9 actually convert, I don't believe; let's look at the issue
10 more seriously.

11 Q When did Goldman Sachs come back and present additional
12 information to your board?

13 A In September.

14 Q Of 2001?

15 A 2001.

16 Q Didn't you indicate earlier in May 2001 you asked them to do
17 that?

18 A No, I asked them in May of 2001 to come to our August - I
19 think it was around about May - to come to our August board
20 meeting in 2001 to talk about what they had previously
21 presented to the board in the '97, '98, time frame, to
22 update the board on what the capital options were and then
23 to see whether the board wanted them to update that study or
24 not.

25 Q Mr. Barlow, I don't know if you still have the Premera

1 exhibits that Mr. Hamje asked you about. It would be
2 Exhibits P-120 and 121. Mr. Kelly has been so kind as to be
3 in charge of that.

4 MR. KELLY: It is my witness. I'm sure you will do
5 the same for me.

6 MR. MADDEN: You know I will.

7 MR. KELLY: It is.

8 MR. MADDEN: 120 and 121?

9 MR. HAMJE: Excuse me. Didn't we use the Staff's
10 exhibits on those, S-71 and S-96? They are the same. They
11 are identical. We could probably go ahead and introduce
12 them as well. I mean, I don't have an objection.

13 MR. MITCHELL: Does it make sense if we have
14 duplicate exhibits to only admit one of them?

15 MR. HAMJE: Right again.

16 MR. KELLY: What are the numbers again?

17 MR. HAMJE: S-71 and S-96.

18 MR. MADDEN: Let's stick with the same exhibits so
19 as not to get confused.

20 A Which one do you want to look at?

21 Q (BY MR. MADDEN) Let's start with the May 30th letter to
22 Commissioner Kreidler, which is --

23 MR. MITCHELL: 71.

24 Q (BY MR. MADDEN) -- 71. Also I believe, if you would - if -
25 well, I won't ask you to handle two books at once. In that

1 letter on the third page there is a list of bullet points.

2 Do you see those?

3 A Yes, I do.

4 Q Okay. Do you see the fourth bullet point, it begins,
5 "Premera will dissolve."

6 A Mm-hmm.

7 Q It states, "Premera will dissolve and distribute its assets
8 comprised of 100 percent of the initial stock of New Premera
9 to a newly formed foundation established to fund support for
10 health initiatives in Washington and Alaska as discussed
11 below, (the 'Foundation Shareholder')."

12 Did you make the identical statement in your letter to
13 Attorney General Gregoire?

14 A It is probably similar, but I would have to read it.

15 Q Okay. That's the Staff's exhibit . . .

16 MR. MADDEN: Help me out, Mr. Hamje.

17 MR. HAMJE: S-96.

18 MR. MADDEN: S-96. Thank you.

19 MR. HAMJE: My understanding is both S-71 and S-96
20 have been admitted.

21 JUDGE FINKLE: Correct.

22 MR. MADDEN: Correct.

23 A It looks similar.

24 Q (BY MR. MADDEN) Same statement?

25 A It looks like it.

1 Q All right. Would you turn, please, back to the Intervenor's
2 exhibits under Tab 5, Exhibit I-5?

3 MR. MADDEN: If I can approach the witness, I will
4 try to help him out.

5 JUDGE FINKLE: Yes, go ahead.

6 THE WITNESS: This one?

7 MR. MADDEN: Yes.

8 THE WITNESS: Okay. All right. Okay.

9 MR. MADDEN: It is the next one.

10 THE WITNESS: I-5?

11 MR. MADDEN: Yeah.

12 Q (BY MR. MADDEN) Do you, Mr. Barlow, recognize the document
13 that has been identified as Intervenor's Exhibit 5?

14 A I believe I do.

15 Q Could you tell the Commissioner what it is?

16 A This is a transcript of the planned speech I was going to
17 give to our - it is called a Performance and Outlook
18 Meeting, which is a meeting that is attended by managers and
19 some of our professional staff, all management and above and
20 some nonmanagement, but basically the management of the
21 company where we update them on what is happening within the
22 company. It used to be on a quarterly basis. We do it
23 about once or twice a year now.

24 Q And - and naturally you were trying to be accurate and
25 straightforward in describing the company's affairs to your

1 management; correct?

2 A I'm always as straightforward as I can be.

3 Q Well, let me - in I-5, did you discuss the proposal that had
4 been disclosed to the Insurance Commissioner and Attorney
5 General less than three weeks previously to convert the
6 company to for-profit status?

7 A Well, right in the second paragraph it refers to it.

8 Q All right.

9 MR. MADDEN: We offer Intervenor 5 at this time.

10 MR. KELLY: No objection.

11 MR. HAMJE: No objection.

12 JUDGE FINKLE: Admitted.

13 Q Mr. Barlow, in your June 19th prepared remarks it is
14 indicated that you intended to tell the company's leadership
15 that Premera, if it did not convert, was fully capable of
16 succeeding at a nonprofit company; correct?

17 A I believe what I said is that we could continue on as a
18 nonprofit and we would be successful.

19 Q Well, but let's not quibble. What you said is quote, on
20 Page 1, "We are fully capable of succeeding as a nonprofit
21 company;" correct?

22 A Just tell me which sentence and I will follow.

23 Q Certainly, on Page 1 --

24 A Mm-hmm.

25 Q -- underlined and italicized heading, "And on May 30th" --

1 A Mm-hmm

2 Q -- the third bullet, the last sentence --

3 A Okay.

4 Q -- says, "But we are fully capable of succeeding as a
5 nonprofit company;" correct?

6 A Correct.

7 Q All right. Let's go over to what is numbered Page 3 of the
8 document. Again, there is an underlined, italicized heading
9 that says, "Without doubt each conversion is different, but
10 four ideas are common to each." And it says, "The first
11 idea is charitable assets." Are you with me?

12 A Yes, I am.

13 Q In here you state that "In other conversions, debates have
14 arisen about whether Blue plans have charitable assets;"
15 correct?

16 A I do. And I go on to say we are not one.

17 Q My next point exactly, but let's go to your third point.
18 You then explain to the management of your company, "But
19 practically speaking, this doesn't matter."

20 And by that you meant, did you not, the debate about
21 whether a Blue plan's assets - or whether Blue plans have
22 charitable assets?

23 A No. What I was - what I was saying is what we are doing is
24 donating the stock of the company so it is not worth the
25 debate as to whether we are from - we are not debating in

1 this forum whether we are charity or not. All I'm saying is
2 we are going forward to donate 100 percent of the initial
3 stock of the company to foundations dedicated to health
4 initiatives.

5 Q Good. Good. We understand each other.

6 But you said something more. You went on to say, "All
7 of the initial stock - in other words, the entire value at
8 the time of conversion;" correct?

9 A I say that.

10 Q The same concept that you conveyed to the Commissioner and
11 Attorney General in the letters of May 30th?

12 MR. KELLY: I will object. Vague. Argumentative.
13 The documents speak for themselves.

14 A I said something --

15 JUDGE FINKLE: Wait. Wait

16 THE WITNESS: Okay. My apologies.

17 JUDGE FINKLE: Overruled. You may answer. We need
18 to keep the order.

19 THE WITNESS: I apologize.

20 A I said something different in that letter, I believe, which
21 it goes on to say in this letter to the Commissioner -
22 looking at the letter to the Attorney General right
23 now where it says, "The foundation shareholder shares in New
24 Premera would be sold in the public market subject to a
25 divestiture schedule consented to the Blue Cross/Blue Shield

1 Association rules and preagreed terms established between
2 New Premera and the foundation shareholder with the approval
3 of applicable regulatory authorities."

4 So it is a little bit - it is not the identical
5 statement. It is a bit more in this letter to the Attorney
6 General and to the Commissioner.

7 Q Do you mean to suggest, Mr. Barlow, that the language you
8 just quoted negates the earlier statement in the letter that
9 Premera will dissolve and distribute its assets?

10 A I didn't say that. You said it is the identical statement.
11 I said it is not. I said this is what we said there and
12 this is what I said here.

13 Q So the answer to my question is no, you did not mean to
14 negate the statement?

15 A No, it is not. You said the same identical words and I
16 didn't use the identical words. I quoted what I said.

17 Q Can you look in the book containing the Intervenor's
18 exhibits, Mr. Barlow, and look what is tabbed as
19 Intervenor's Exhibit 2?

20 A (Complying.)

21 Q This is a memo dated October 15th, 2002, from Deputy
22 Attorney General David Walsh and others to the Attorney
23 General. Did Premera at some point become aware that this
24 memo existed and had been transmitted to the Insurance
25 Commissioner?

1 A I believe we were aware.

2 MR. MADDEN: We would offer Intervenor 2, Your
3 Honor.

4 MR. KELLY: We have no objection.

5 MR. MITCHELL: For point of reference, I-2 is
6 included in S-97 and it might be more efficient to use the
7 Staff designation because it is certified.

8 MR. MADDEN: I agree. We could clear this up. I'm
9 just sort of in the lateness of the date and wanting to get
10 Mr. Barlow concluded. I don't want to have him go chasing
11 another book.

12 JUDGE FINKLE: I-2 is admitted.

13 Q (BY MR. MADDEN) Mr. Barlow, did Premera become aware that
14 the Walsh memo, as I'm going to call it, was being treated
15 as kind of a legal blueprint for the analysis to be
16 performed by the OIC and the Attorney General concerning the
17 proposed transaction?

18 A I would have to read the entire document to be able to
19 conclude whether it was a blueprint as you suggest. I don't
20 recall reading it in any detail before.

21 Q All right. Let me withdraw that question.

22 To your knowledge, has Premera informed the Attorney
23 General that it believes that the Walsh analysis is
24 incorrect?

25 MR. KELLY: I will object. It is calling for a

1 legal conclusion.

2 JUDGE FINKLE: Overruled.

3 A Could you repeat your question, please?

4 Q (BY MR. MADDEN) Sure. To your knowledge, has Premera
5 informed the Attorney General that it believes that the
6 Walsh analysis contained in Exhibit I-2 is incorrect?

7 A I would have to read it to be able to try and put it in
8 context of whether we objected or not.

9 Q The question is did you communicate an objection to the
10 Attorney General?

11 A I understand, but I'm not sure. You know, I see a lot of
12 documents that - and this is fairly old - that have gone
13 around this conversion. And I'm not sure whether - what is
14 in here exactly and whether we objected to it or not.

15 Q Let me - let me direct your attention specifically to some
16 statements that appear on Page 4 of Exhibit I-2.

17 A Sorry. Could you repeat the --

18 Q Sure, Page 4 --

19 A Yeah.

20 Q -- the paragraph that begins at the top of the page states,
21 "A third role for the Attorney General's office."

22 A Okay.

23 Q The second and third sentences of that paragraph state, "The
24 Nonprofit Corporation Act provides in part that the Attorney
25 General must approve any plan of distribution of assets, the

1 use of which is limited to charitable or other similar
2 purposes as provided in RCW 24.03.225. Thus, under the law
3 any transfer of the assets of Premera to another entity will
4 require the Attorney General's approval."

5 To your knowledge, has Premera informed the Attorney
6 General that it believes that the Walsh analysis that I have
7 just quoted is incorrect?

8 A I'm not sure if we informed the Attorney General directly.
9 We have certainly informed others that - first of all, I
10 don't - the first part of - the first sentence, "that the
11 Attorney General must approve any plan of distribution which
12 is limited to charitable or other similar purposes," we
13 don't disagree with that. What we don't agree with is that,
14 to our knowledge, none of the assets of Premera are subject
15 to a - charitable for similar purposes.

16 Q But correct me if I'm wrong, Premera asked the Attorney
17 General to review the proposed transaction?

18 A I don't believe we asked. I don't believe that we asked -
19 that we - did you say "approve"?

20 Q Review.

21 A We asked - we suggested to her that she would be interested
22 in - by writing that letter that you pointed out earlier,
23 that obviously she would be interested to do her due
24 diligence as to whether they are assets or not or charitable
25 assets or not.

1 Q Mr. Barlow, in your responsive testimony - I believe it is
2 at Page 2 - you state your conclusion that Premera is not a
3 charitable corporation is based on the proposition that a
4 company that offers health insurance in exchange for
5 premiums cannot be a charity; is that correct?

6 A Could you point out what --

7 Q Page 2 of your prefiled responsive testimony.

8 A Page 2 of the --

9 MR. KELLY: That would be Exhibit P-7.

10 A Exhibit P-7. Could you just lead me to the page again?

11 Q (BY MR. MADDEN) Page 2 of the responsive --

12 A Mm-hmm. Okay. What - what - what line?

13 MR. KELLY: Line, Counsel?

14 Q (BY MR. MADDEN) The conclusion that you state at Page - at
15 Line 19 through 22, is that based on the premise that a
16 health carrier that offers insurance in exchange for
17 premiums cannot be a charity?

18 MR. KELLY: Counsel, I may be missing the point
19 here. I'm looking at what I think is P-7, Page 2, Line 19.
20 It is a question, so am I missing something?

21 MR. MADDEN: The answer continues to Line 22.

22 MR. KELLY: Okay. So - I'm sorry. Can the court
23 reporter read back the question?

24

25 (Reporter read back question.)

1

2 A I believe my answer is as stated. To the best of my
3 knowledge, Premera assets are subject to any limitations
4 because to the best of my knowledge, we have received no
5 charitable contributions and that we have provided health
6 coverage in exchange for premiums paid in cash.

7 Q (BY MR. MADDEN) Are you familiar with the responsive
8 testimony that's been offered on behalf of Premera by Lewis
9 Reid?

10 A I have read it.

11 Q Mm-hmm. Do you recall that - that . . .

12 MR. MADDEN: And this is Exhibit P-12 --

13 MR. KELLY: Okay.

14 MR. MADDEN: -- at Page 8.

15 MR. KELLY: Hold on for a minute while I get a copy.

16 MR. MADDEN: Certainly.

17 Q (BY MR. MADDEN) I believe that that page - oh, I'm sorry.
18 Mr. Kelly is still digging.

19 MR. KELLY: I got it. Okay.

20 Q (BY MR. MADDEN) At Page 8 of his responsive testimony
21 Mr. Reid says, "In any event, the discussion of fair market
22 value is a distraction" referencing the discussion between
23 the experts about whether the proposed transaction will
24 result in the transfer of fair market value to the
25 charitable foundations.

1 MR. KELLY: Counsel, I'm probably just slow. Where
2 is the word "distraction"? What line?

3 MS. SUREAU: I'm lost, too.

4 MR. MADDEN: I'm probably as slow as you are,
5 Counsel. I just copied this out of the prefile. You're not
6 finding it?

7 MR. KELLY: No.

8 MR. MADDEN: I'm sorry. Page 7. Let's back up. It
9 begins at the bottom of Page 7.

10 Q (BY MR. MADDEN) Do you see where Mr. Reid says, "The
11 discussion of fair market value is a distraction"?

12 A Yes, on the previous page. Mm-hmm.

13 Q Do you share Mr. Reid's view?

14 A Let me read the whole thing then. Give me a moment to
15 familiarize myself with where we are.

16 Okay. I have read Line 21, 22 and Page 1 - and Page 8,
17 Lines 1 and 2 and I agree with what has been said that far.

18 Q So you agree that any consideration by the Commissioner or
19 Attorney General of whether the proposed transaction will
20 result in the transferral of fair market value to the
21 charitable foundations is a distraction?

22 MR. KELLY: Well, I will object. It is not a
23 correct statement when you put the word "fair market value"
24 in there, Counsel.

25 JUDGE FINKLE: Sustained.

1 Q (BY MR. MADDEN) Do you agree with the statement made by
2 Mr. Reid that the discussion of fair market value is a
3 distraction?

4 A I agree with the proposition that a conversion should be
5 judged in terms of the Holding Company Act, which goes to
6 some pretty specific language about when it should be
7 disapproved, and absent those requirements, it should be
8 approved.

9 I don't remember reading in there anything about - to
10 the notion of 100 percent of the company's stock as part of
11 forming a conclusion as whether the conclusion in particular
12 would be harmful to the policyholders or the insurance
13 buying public, so therefore the focus around this donation
14 in this context perhaps is a distraction.

15 Q You called it "a donation." Is that another word in your
16 vocabulary at least for a gift?

17 A Yes. It is a gift. We are talking about the gift of 100
18 percent of the initial stock.

19 Q I understand.

20 Is it important to the success of Premera's proposed
21 conversion that the IRS treat it as a reorganization rather
22 than a sale?

23 MR. KELLY: Objection. I think this does call for a
24 legal conclusion. He can give his own knowledge on it.

25 MR. MADDEN: Let me rephrase the question.

1 Q (BY MR. MADDEN) From your perspective as CEO of the
2 company, is it important to the success of the proposed
3 transaction that the IRS treat it as a reorganization rather
4 than a sale?

5 A It is important for the success of the transaction, from my
6 perspective, in the first instance that Premera pay no taxes
7 on the conversion. I'm talking about relative to the
8 reorganization, because obviously that would subtract from
9 our risk capital.

10 Q And Premera has engaged tax accountants to advise it on that
11 score, has it not?

12 A Yes, it has.

13 Q And has Premera in turn made those tax opinions available to
14 the OIC staff and consultants?

15 A I believe we have. I believe we received an opinion from
16 Ernst & Young immediately before these hearings.

17 Q And - and have you, as CEO, requested that your lawyers and
18 staff in dealing with the OIC and its consultants let them
19 know immediately if they detected anything inaccurate in
20 those tax opinions?

21 A Which tax opinions?

22 Q The tax opinions which your company has obtained in support
23 of this proposed conversion.

24 A If there was an opinion that was inaccurate, I would expect
25 that our staff would inform the OIC in due course.

1 Q One last area of questioning, Mr. Barlow, regarding the
2 proposed foundations. Is it correct that under the articles
3 and bylaws of those yet to be formed entities that there
4 could be no Hospital or Medical Association representatives
5 on their boards?

6 A No Hospital or Medical Association representatives on the
7 boards? That is correct.

8 Q Okay. And why is that?

9 A I believe that there is a wealth of knowledgeable people -
10 who are knowledgeable on unmet health needs who are not on
11 the Hospital Association or the Medical Association boards
12 who could be represented on the foundation board.

13 Q No doubt that's true, but why did Premera - it was Premera's
14 decision. This not a decision by the Blue Cross Commission,
15 correct, to exclude Hospital and Medical Association
16 representation?

17 A I don't believe - I don't know whether it is a Blue rule,
18 but I'm in agreement with the proposal, that is correct.

19 Q And that proposal would exclude the views of the Hospital
20 and the Medical Associations from the board?

21 A Well, no. It excludes representatives of the Hospital and
22 Medical Associations on the board. Their views can be
23 solicited in other ways other than direct representation on
24 the board.

25 MR. MADDEN: Thank you. I have no further

1 questions.

2 MR. KELLY: Okay.

3 JUDGE FINKLE: Other Intervenors?

4 MS. McCULLOUGH: Just one moment.

5 No questions. Thank you.

6 JUDGE FINKLE: Redirect?

7 MR. KELLY: I think I could complete this in perhaps
8 10 minutes.

9 JUDGE FINKLE: Let - how about much do you think you
10 will have, if any?

11 MR. HAMJE: I don't have any right now.

12 JUDGE FINKLE: Okay. Let's complete the witness, if
13 we can, and then we will conclude for the day.

14 MR. KELLY: Thank you. I'm going to try and go
15 through pretty much chronologically some of the questions
16 that you were asked. I only have a handful.

17

18 REDIRECT EXAMINATION

19

20 BY MR. KELLY:

21 Q Now, early in the questioning, you were asked about the
22 reasons for establishing the foundation. And let me ask you
23 the question this way: If indeed the articles of Premera
24 provide that upon dissolution the net assets go to nonprofit
25 corporations, would you agree that that would be yet another

1 consideration that the company would be taking into effect
2 when it decided to give the 100 percent of the stock to
3 these two foundations?

4 A Yes, it would.

5 Q Okay. The next area is there was a discussion of this
6 exhibit - it is an excerpt from the Commissioner's Exhibit
7 No. 1, and you don't need to go to the page, but your
8 attention was directed to a question as to whether Premera
9 would commit that it intends to continue to do something.
10 Let's see what it is. Committed to development of a
11 customer-focused care facilitation approach. And you
12 indicated that you intended to do that.

13 Is it fair to say that whether you will be able to do so
14 in the future depends on what the status of your capital
15 reserves are?

16 A That is correct. Any program that we undertake and that
17 would be an initiative to - that would be in the interest of
18 our subscribers, but we have to balance every initiative
19 against the available capital that we have at the time. So
20 our decision as to whether to pursue that particular
21 initiative would be dependent on the available capital and
22 the competition for the resources that might exist at the
23 time from other initiatives that might be beneficial to our
24 subscribers.

25 Q Okay. Now, Mr. Hamje went on to ask you some questions

1 about the timing of the meetings with the Blue Association
2 on these three provisions. Do you recall that?

3 A On the duplicate foundation --

4 Q Yes.

5 A -- provision?

6 Yes.

7 Q There seemed to be some suggestion that we didn't move as
8 fast as we could, Premera that is. But let me ask you this:
9 Is it your understanding that up through December of last
10 year the original Form A had only one foundation that would
11 actually receive the stock and it was only changed when the
12 Amended Form A in February of 2004 to two foundations, thus
13 leading to these three related problems that only relate to
14 two foundations; is that your understanding?

15 A That is my understanding.

16 Q And when everyone went home at Christmastime after these
17 discussions were going on, the OIC staff and its consultants
18 had not yet raised the issue of maybe we should have two
19 foundations; isn't that true?

20 MR. HAMJE: Forgive me, but there is a lot of
21 leading questions here. Really Mr. Kelly is testifying and
22 not the witness. I would object.

23 JUDGE FINKLE: Sustained.

24 MR. KELLY: Okay. I will rephrase it.

25 Q (BY MR. KELLY) What is your understanding as to when

1 Premera was first informed that OIC and its consultants
2 thought it would be a good idea to have two foundations
3 rather than one?

4 A Well, I - I think that the OIC consultants may have asked
5 for two foundations earlier. I'm not sure. But when they -
6 from - my understanding is that the conversations and the
7 negotiations that took place in December did not involve the
8 insistence that there be two foundations, that various
9 changes were going to be made to the Form A. That is what
10 was being negotiated. But the premise at that point was
11 that it was one foundation.

12 In January my understanding is that the OIC consultants
13 came back and the Alaska consultants came back and insisted
14 that they needed to - there needed to be two foundations. I
15 understood at time to partly to deal with some of the issues
16 around the split and how - what the different rights would
17 be between the two respective interests of the states.

18 So in January we then proceeded to go through a lot of
19 diligence in making the changes which flowed throughout
20 those documents. It was a very complicated thing, but
21 nevertheless got accomplished in our February filing. And
22 so that would be the time period for us to clearly take it
23 to the - to the Blue Cross/Blue Shield Association. It was
24 after January and into February.

25 Q Okay. And certainly the concept of duplicative rights for

1 the foundations first came into the discussion sometime in
2 January?

3 A That is my understanding.

4 Q Okay. Now, shortly after that what actions did you take
5 or - to try and deal with these new developments?

6 A We - our staff spoke to the staff of the Plan Performance
7 Financial Standards Committee of the Blue Cross/Blue Shield
8 Association about these changes and they gave the opinion
9 that on these duplicative rights that they would not be
10 approved and they would not be recommended by them to the
11 PPFSC.

12 So, as I testified earlier, we then went ahead and filed
13 without the duplicative rights and after the filing went and
14 presented our case to the PPFSC asking for these duplicative
15 rights.

16 Q Do you think that you moved as quickly as you could given
17 everybody's commitments and schedules for committee meetings
18 and so forth to get to the Blue Association and try to
19 resolve this?

20 A Absolutely. We were very fortunate to get the attention of
21 PPFSC, which does deal with 42 plans. And to throw this on
22 to their agenda at the last minute was not an easy
23 accomplishment and they really accommodated us in - in
24 meeting with us at - I believe it was 7:00 in the morning.
25 A special meeting was called to deal with this issue.

1 Q Okay. Now, I would like to direct your attention to one of
2 those many books up there. It is the Intervenor's volume and
3 it is I-3, which is this letter to Senator Thibaudeau.

4 A Is this the Intervenor's?

5 Q It is the one with all the Is.

6 A Okay. Is it this one (indicating)?

7 Q I think it is.

8 A They don't have Is on them, but --

9 Q It is Number 3, February 17, 2000, letter.

10 A It is a letter to Senator Thibaudeau. It doesn't have an I
11 on it, but . . .

12 Q I see. Okay.

13 First, very quickly, the context here is former
14 Commissioner Senn had a proposal that you were opposed to -
15 you, Premera, was opposed to the proposal; is that correct?

16 A I believe that our analysis was that this was a rush of
17 legislation that needed a lot more careful consideration
18 that couldn't possibly occur in the time frame that was
19 available in a short session of the legislature.

20 Q Did Group Health and Regence also have the same concerns?

21 A I believe they did. I know that Regence did. I don't
22 recall exactly what Group Health's position was.

23 Q Now - and the reason for this time period was so that
24 Commissioner Senn could submit her proposed legislation the
25 next session, it could be debated and discussed and she

1 would not have the worry that Premera was trying to do
2 something before that occurred?

3 A Correct.

4 MR. HAMJE: Objection. Leading.

5 JUDGE FINKLE: Sustained.

6 Q (BY MR. KELLY) Why don't you describe what the reason was?

7 A All right. The reason that we submitted this letter was
8 that we didn't want legislation pushed through that might be
9 ill-advised on the assumption that it is not pushed through,
10 that somehow Premera might convert before there was a law in
11 place. So that's why we made the commitment not to convert
12 prior to the end of the next session. We all know that this
13 is a long time after that next session.

14 Q Now, if you could turn to Page 2 of the letter, does the
15 language actually say, "Will not convert or transfer
16 control"? Am I reading that correctly in the next to the
17 last paragraph?

18 A It says both. It says, "We give you our commitment that
19 Premera Blue Cross will not convert from its current
20 nonprofit corporate status to for-profit status or transfer
21 control of Premera Blue Cross to a for-profit entity between
22 now and the close of the next legislative session."

23 Q And you complied with that, did you not?

24 A We absolutely did.

25 Q Now, that letter didn't say that you wouldn't even look at

1 the idea of conversion at all; is that --

2 MR. HAMJE: Objection. Leading.

3 JUDGE FINKLE: Sustained.

4 Q (BY MR. KELLY) What did the letter say about whether you
5 had any inhibitions on looking in any way at conversion?

6 A I don't believe it touched on it at all. I don't know how
7 you could draw the implication that we were not thinking
8 about conversion. It is not that we were, we were not, but
9 by the statement saying that we would not convert or
10 transfer control does not say we are not doing any other
11 things. There are many others things we might be doing. We
12 were very explicit as to what we wouldn't do.

13 Q Okay. Now, just two more areas of questions and then I
14 should be done.

15 If you would turn to S-71, which is the letter that -
16 the May 30, 2002, letter to Kreidler. Maybe if you could
17 find S-96.

18 A Not S-71, you want S-96?

19 Q S-96, yes.

20 A Okay. Got it.

21 Q Do I have that?

22 Okay. Now, this letter to the Attorney General, do you
23 have it in front of you there?

24 A I do.

25 Q Okay. If you would turn to Page 2 and the headline is

1 "Health Plan Conversions Nationally" --

2 A Got it.

3 Q -- am I reading this correctly in the first sentence it
4 says, quote, "While Premera and its predecessor companies
5 were not established or operated as charitable institutions"
6 and it goes on to talk a little bit further.

7 So is it your understanding that the Attorney General
8 was advised as early as May 30, 2002, and long before the
9 Walsh memo, as to what Premera's position was as to whether
10 or not it was a charity?

11 MR. HAMJE: Objection. Leading.

12 JUDGE FINKLE: Sustained.

13 A We did --

14 MR. KELLY: I have to rephrase the question.

15 Q (BY MR. KELLY) What information do you understand the
16 Attorney General had as early as May 30, 2002, as to whether
17 Premera was taking the position that it was or was not a
18 charity?

19 A We informed the Attorney General that Premera and its
20 predecessors were not established or operated as charitable
21 institutions.

22 Q Okay. What - is there any provision in - or any statement
23 in the Form A that was filed in October 2002 as to whether
24 or not Premera was a charity?

25 A I believe that it did not say that.

1 Q Okay. Now, that was one of the purposes I wanted look at
2 that letter. Let me ask you to look at the next page, 3.
3 And I think you had read or there was discussion by
4 Mr. Madden about the fourth bullet point talking about the
5 100 percent of the initial stock --

6 A Yes.

7 Q -- and then a more lengthy explanation in the following
8 paragraph as to specifically and legally what it was and
9 what conditions Premera was going to transfer.

10 Now, hold that, if you would, as a fact and turn your
11 attention to Exhibit I-5. And that is an outline of a talk
12 you were going to give; is that correct?

13 A That's correct.

14 Q Okay. Now, first of all, let's look at the dates. Which
15 occurred first, the letter to Ms. Gregoire and the letter to
16 the Commissioner or this talk that you gave?

17 A We met with the Commissioner and the Attorney General
18 Gregoire - I believe it was on May 30th when this letter was
19 written and given to them on those - on that day.

20 Q Okay.

21 A So that preceded the Performance and Outlook Meeting, which
22 is the subject of - I believe it is I-5 --

23 Q Okay.

24 A -- which was on June 19th.

25 Q And does the May 30th, 2002, statements regarding what it is

1 that is being provided, does that accurately reflect your
2 understanding of Premera's position as of that time?

3 A Yes, it did and does.

4 Q Okay. Now, is there any difference in the formatting of the
5 talk that you were giving to your folks as opposed to the
6 letter that you were writing to the Attorney General of our
7 state and to the Insurance Commissioner of our state?

8 A Yes. This is obviously written to the Insurance
9 Commissioner and to the Attorney General, which is a very
10 formal document. And the Performance and Outlook Meeting
11 tends to be a more formal gathering of our management. Some
12 probably 300 people were at this meeting.

13 Q Okay. And turn to Page 3 of Exhibit I-5, you had a couple
14 of bullet points that you were trying to get across to the
15 gathering in June; is that correct?

16 A That's correct.

17 Q And what do you think would have happened if when you got to
18 the third or fourth bullet point instead of saying what you
19 said you said what you said in detail in this letter of May
20 30th, 2002?

21 A Well, I think the level of sophistication, with all due
22 respect, of the people that were at that meeting would not
23 have comprehended exactly what was being said in - the eyes
24 would have been glazed over, to put it mildly.

25 It is not the sort of - this is a speech to start the

1 Performance and Outlook Meeting. It is - you can't get into
2 legalese too much with what one is saying, although I think
3 it is still pretty well-expressed what we are doing.

4 Q Okay. Excuse me.

5 MR. KELLY: That's all I have. Thanks.

6 MR. HAMJE: I do have some questions.

7
8
9 RECROSS-EXAMINATION

10
11 BY MR. HAMJE:

12 Q Mr. Barlow, who attended this Performance and Outlook
13 Meeting.

14 A The Performance and Outlook Meeting, as I explained earlier,
15 is - at that time was a quarterly meeting that we held more
16 or less for management and some professional staff, so from
17 the CEO, senior management down to team lead type of level
18 and some professional staff.

19 Q Let's go back - I wanted to ask you about the two
20 foundations question again. Isn't it true that in February
21 2003 the consultants suggested that there should be two
22 foundations established?

23 A I understand from reading some of the testimony in the
24 filings that that had occurred. I was - I had not recalled
25 it before that. I don't believe I was involved in that

1 specific discussion.

2 Q Isn't it also true that Premera refused to make any changes
3 in its Form A until after the reports were filed by the OIC
4 staff's consultants in October?

5 A I believe that is correct.

6 Q Okay.

7 MR. HAMJE: Pass the witness. Thank you.

8 MR. MADDEN: No questions.

9 MR. KELLY: No redirect.

10 JUDGE FINKLE: I believe the Commissioner has a
11 couple of questions.

12

13 EXAMINATION

14

15 BY COMMISSIONER KREIDLER:

16 Q To follow on the action of the Blues, I saw where they
17 rendered an opinion relative to the Washington Alaska
18 foundations, but they didn't give any reasons for their
19 actions.

20 I presume that at some point, Mr. Barlow, they informed
21 you to what the reasons were but they weren't delineated in
22 that letter.

23 A You are referring, Commissioner, to the letter that Roger
24 Wilson wrote to - my understanding of the reasons is that
25 the Association had established, going way back to 1994, the

1 circumstances surrounding for-profit companies within the -
2 and one of those rules was around stock ownership.

3 So, once again, they established that there could be
4 exceptions to the stock ownership but it had to be approved.
5 And they had approved various changes to that along the way
6 and had approved the WellChoice model, which didn't include,
7 in their opinion, any of these duplicate foundation rights.
8 So that's the background. When they asked them to make a
9 change and they made one change and that - they may have
10 discussed the logic of why they would not allow two five
11 percent free votes with our staff. I don't believe I have
12 heard it specifically. The other was around whether they
13 should be a single sell down schedule for the stock. And I
14 don't recall any discussion from them on that, but that was
15 their position.

16 Now, we can - I just haven't had an opportunity to go
17 back and speak to the general counsel and ask them exactly
18 why it is. We obviously had to get prepared to get here, so
19 we just got what we got.

20 Q It was just kind of curious for me --

21 A Right. I don't --

22 Q -- in - the opinion, the rationale?

23 A I don't know the exact rationale, why they would not allow
24 it.

25 Q If I'm not mistaken --

1 A And sorry to interrupt you. Just bearing in mind, we
2 advocated the opposite.

3 Q Right.

4 A And they were happy to go with the opposite, so I'm not
5 clear why they - why they were concerned with it.

6 Q Am I correct that the Blues Association did not allow
7 for-profit association members until the 1990s?

8 A Until 1994. I believe that that is correct, that the rules
9 were changed to allow for-profit conversion in 19 - 1994.
10 Up until that point, I believe that all Blues were required
11 to be nonprofit.

12 Q That was certainly my understanding --

13 A Yes.

14 Q -- historically. It must have been driven by the WellPoint
15 conversion, at least it was the largest event that occurred.

16 A Right. Well, just to give some color on that, there were a
17 lot of nonprofits that were converting in the '80s and early
18 '90s and particularly in California, which is WellPoint's
19 home base.

20 I think WellPoint concluded if they were going to be
21 able to complete for the future, they needed to have access
22 to capital and that's what really drove them to want to
23 change and therefore were - managed to convince the rest of
24 the Association that rules should be changed.

25 Q Some would say, at least in part, because the Association

1 was losing a lot of members if it didn't adapt?

2 A That is true. The Blue Association was - did lose a lot of
3 membership, which we are now back again at all time highs
4 within the Blue Association. But at that time point, there
5 was certainly a lot of membership loss.

6 Q This - if I could ask a - I can't even remember exactly the
7 context for it, but it dealt with the issues that you raised
8 relative to profitability about product. It appears that a
9 fair amount of the profitability by product is certainly
10 driven by what others have described as fragmentation that
11 you see in the healthcare system today, at least for the
12 insurance system today, but not much focus has fallen on
13 utilization, at least not to any degree. It has focused a
14 great deal more on the profitability by product.

15 In conversion, would that change? Would there be more
16 focus on profitability by product, i.e. arguably
17 fragmentation? Would there be less or the same or the same
18 relative to utilization, which some say is from lack of
19 focus on the part of health care in general? How would
20 conversion impact that?

21 A We - I think Dr. Chauhan is one of the witnesses who will be
22 talking about our care facilitation programs that do address
23 the issue of utilization, which is the core of the question
24 is is this being addressed. Which obviously two major
25 factors driving healthcare costs; one is the price per unit

1 in other words, the amount that we pay for each unit to
2 service is going up every year, but utilization is going up
3 every year, too, particularly with increased technology and
4 the baby boom generation and aging.

5 We are very concerned, as we should be, about this issue
6 and have embarked on several programs to try and contain the
7 increase in utilization. One of the important facts I think
8 that one gives by - from studies that 30 percent of
9 healthcare dollars are wasted through excess procedures, et
10 cetera. And we are - I believe that the whole healthcare
11 system needs to look to evidence-based medicine for what
12 should - what procedure should be performed on behalf of
13 patients.

14 There is so much variability today from best practices
15 and that is where we are directing a lot of our efforts.
16 And Dr. Chauhan will talk about that in his testimony to
17 you.

18 Q But you don't make a connection in the conversion for a
19 nonprofit to a for-profit as having an impact necessarily on
20 utilization?

21 A The - our management of these programs, which I think are
22 highly responsive to the needs of our members as well as to
23 the employer groups who generally foot the bill, are
24 designed once again - but they are initiatives, so they are
25 designed to focus on improving utilization. It does consume

1 some of our resources, so to the extent that their
2 initiative versus some of the initiatives competing for
3 resources, we would obviously have to look at it. And if
4 conversion provides us with additional capital at the time
5 that we need it, then it will impact whether we do that
6 program or not. But I will say we intend to pursue those
7 programs. They are high on our list of priorities.

8 Q Do you think fragmentation in the healthcare system is held
9 neutral? Is it better or worse for conversion?

10 A I believe it is held neutral. There is fragmentation to -
11 within the system, not particularly related to the
12 profitability of products. I don't - I don't draw that
13 connection that you drew earlier, but obviously when you
14 have got the federal system setting the pace through
15 Medicare and you end up with the Medicaid system and private
16 health plans, there is fragmentation. That is the reality
17 of the marketplace that we have. Conversion will not affect
18 that.

19 Q Thank you.

20 JUDGE FINKLE: Follow-up by Premera on those points?

21 MR. KELLY: None.

22 MR. HAMJE: Just one question.

23
24 RECROSS-EXAMINATION

1 BY MR. HAMJE:

2 Q Mr. Barlow, I just want to confirm that any decision by the
3 Blue Cross/Blue Shield Association does not bind the
4 Commissioner; is that right:

5 A That's correct. The Blue Cross/Blue Shield Association have
6 rules and they are not encouraging us to convert or
7 discouraging us to convert. They says these are the rules
8 that have been set over years now to protect the brand. We
9 are not dictating whether you should convert or not convert.
10 All we are saying is if you want to hold our license, there
11 are certain rules that you have to - to follow.

12 MR. HAMJE: Thank you.

13 JUDGE FINKLE: Intervenor follow-up?

14 MR. MADDEN: None.

15 JUDGE FINKLE: Okay. Thanks, we will see you
16 tomorrow at 9:00.

17

18 (Proceedings adjourned.)

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C E R T I F I C A T E

I, KRISTIN D. MANLEY, a court reporter in the State of Washington, do hereby certify that I was present during the foregoing matter and reported said proceedings stenographically.

I, DO FURTHER CERTIFY that the foregoing transcript constitutes a full, true, and accurate transcript of that portion of my stenograph notes so taken and so ordered.

I, DO FURTHER CERTIFY that I am not related to any of the parties to this lawsuit, nor am I interested in the outcome thereof.

Dated this 4th day of May, 2004.

KRISTIN D. MANLEY

CCR NO. 2211